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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 242

PHILADELPHIA COMPANY AND CERTAIN UNDERLIERS, PETITIONERS,

vs.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY AND THOMAS J. HOFFMAN, ETC., ET AL.

No. 243

PHILADELPHIA COMPANY AND CERTAIN UNDERLIERS, PETITIONERS,

vs.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY AND THOMAS J. HOFFMAN, ETC., ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JULY 15, 1940.

CERTIORARI GRANTED OCTOBER 14, 1940.

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INDEX.

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—477

[fol. 1]

IN UNITED STATES DISTRICT COURT, WESTERN DISTRICT OF PENNSYLVANIA

Relevant Docket Entries

1938

May 10. Filing fee ..... $110.00.

May 10. Petition of Pittsburgh Railways Company to effect a Plan of Reorganization filed. (C. M.)

May 10. Order made approving said petition as properly filed; directing that debtor continue in possession of its property; and fixing June 9, 1938 as time for hearing to determine whether debtor shall continue in possession or a Trustee appointed. (C. M.)

May 27. Proof of publication filed by debtor of filing of petition of May 10, 1938.

June 3. On petition of H. Fred Mercer, et al., order made authorizing H. Fred Mercer, Morris G. Levy, Walter L. Dipple and James P. McArdle, members of the committee known as "Tort Creditors Committee" to intervene generally in this proceeding on behalf of all other Tort Creditors who may join with said Committee.

June 8. Proof of service of notice of hearing fixed for June 9, 1938 filed Re: continuing debtor in possession or appointing Trustees, filed.

June 9. Hearing on the matter of appointment of Trustees before Judge McVicar. Hearing Memo. filed.

June 10. Hearing on matter of appointment of Trustees before Judge McVicar. Hearing Memo. filed.

[fol. 2] June 14. Order made appointing W. D. George, Thomas M. Benner, Esq., and Thomas Fitzgerald as Trustees for Pittsburgh Railways Company; they to file bond in the sum of $100,000.00; directing that these proceedings be referred to Watson B. Adair, Esq., as Special Master; fixing September 14, 1938 as time on or before which claims shall be filed with said Special Master, provided that claims for damages based upon causes of action arising on or before August 1, 1938, may be filed within thirty days after entry of judgment thereon; Plan of Reorganization shall be filed by debtor on or before December 14, 1938. (C. M.)

June 15. Trustees' bond approved and filed—Pittsburgh

Railways Company (Globe Indemnity Company—$100,000.00).

July 22. Amendment to order of Court dated June 14, 1938 for appointment of permanent Trustees for debtor filed by leave of Court.

Oct. 28. On petition, order made directing that the order of Court of June 3, 1938 be amended by adding thereto Ben Paul Brasley, Esq., and Thomas J. Hoffman, Esq., as members of the Tort Creditors Committee in these proceedings.

Nov. 7. On petition, order made directing that the appointment of Thos. Fitzgerald, as one of the Trustees of debtor shall be deemed to be an appointment of said Thos. Fitzgerald as an additional Trustee for the purpose of operating the business of the debtor in conjunction with the other Trustees; that the appointment of Thos. Fitzgerald as one of the Trustees of Subsidiary shall be deemed to be an appointment of said Thos. Fitzgerald as an additional Trustee for the purpose of operating the business in conjunction with the other Trustees; that all provisions of the Chandler Act shall henceforth apply to this proceeding; that W. D. George and Thomas M. Benner, two of the Trustees shall [fol. 3] file a plan of reorganization on or before June 1, 1939 or a report of their reasons why a plan cannot be effected as to the debtor and the Subsidiary that said Trustees give notice to creditors and stockholders.

Nov. 7. Answer of debtor and of Subsidiary to petition of Trustees Re: applicability of the Chandler Act with respect to plan of reorganization, filed.

1939

Jan. 9. Order made referring all matters, both as to the debtor and (to) the subsidiary, not reserved to the Judge by the provisions of Chapter X of the Chandler Act, to Watson B. Adair, Referee, to hear and determine same; provided that claims of creditors and interests of stockholders and objections thereto and the various other matters which were referred to a Special Master by paragraph 11 of order of Court of June 14, 1938, as amended, relating to Pittsburgh Motor Coach Company, are not hereby referred to the Referee, but the provisions of orders dated June 14, 1938, as amended, with respect to those matters shall remain in full force and effect.

March 10. Order made directing that the petition of trustees Pittsburgh Railways Company and Pittsburgh Motor Coach Company for instructions with respect to certain taxes of debtor and subsidiary be referred to Watson B. Adair, Special Master for hearing and report, hearing to be held March 28, 1939, at 10:30 A. M.

March 17. Proof of mailing notice of hearing to be held by Special Master on March 28, 1939 re: Instructions as to the payment of certain taxes filed.

Aug. 22. Special Master's Report on Petition of Trustees filed March 10, 1939 with Instructions with Respect to Taxes filed (C. M. 4); together with transcript of testimony taken at hearing; objections to the Tort Creditors Committee to [fol. 4] payment of taxes or tax items set forth in the petition of trustees filed March 10, 1939.

Aug. 24. Proof of mailing notice in re: Special Master's Report on Petition of Trustees for Instructions with Respect to Taxes filed.

Aug. 28. Order made directing that the date for hearing on petition of trustees and on the report of the Special Master re: taxes and on any exceptions filed to said report of Special Master be adjourned to Sept. 12, 1939 at 10 A. M.

Sept. 11. Exceptions Ex Parte Allegheny, Bellevue and Perrysville Railway Company, et al., to the report and recommendations of the Special Master on Petition of Trustees, filed March 10th, 1939, for instructions with respect to taxes, filed.

Sept. 11. Exceptions to the report and recommendations of Special Master filed March 10, 1939 for instructions with respect to taxes filed by the Trustees of debtor company filed.

Sept. 11. Exceptions and Objections of The Allegheny Traction Co. to Report of the Special Master in Re: Petition of Trustees for instructions with respect to payment of taxes, filed.

Sept. 12. Exceptions of Suburban Rapid Transit Street Railways Company to report of Special Master re: petition of trustees for instructions with respect to payment of taxes, filed.

Sept. 12. Exceptions of Citizens Traction Company to the Report of Special Master re: Petition of Trustees for Instructions with respect to payment of taxes, filed.

Sept. 29. Joinder of Samuel H. Putnam in exceptions to report and Recommendations of Special Master on Petition

of Trustees filed March 10, 1939, for instructions with respect to taxes, filed.

[fol. 5] Oct. 3. Hearing on Report of Special Master re: Petition for Instructions as to Payment of Certain Taxes held before Judge McVicar. Same day hearing concluded. (Hearing Memo. filed.)

Oct. 26. Opinion filed by Judge McVicar. Re:—Certain Taxes. (C. M. 4.)

Oct. 26. Order made directing that the Trustees pay certain taxes, together with any penalties and interest which may have accrued thereon; that the exceptions filed to the report of the Special Master, upon said petition be sustained in so far as they are in accordance with the provisions of this order and are dismissed in so far as they are not in accordance therewith. (C. M. 4.)

Oct. 28. Acceptance of service of decree and opinion re: payment of certain taxes filed. (2.)

Nov. 25. Notice of Appeal of Tort Creditor's Committee to the Circuit Court of Appeals filed.

Nov. 25. Bond on Appeal of Tort Creditors' Committee filed.

Nov. 25. Copy of Notice mailed to Circuit Court of Appeals.

Nov. 25. Copy of Notice mailed to attorneys for Appellee.

Nov. 25. Notice of Appeal of City of Pittsburgh to the Circuit Court of Appeals filed.

Nov. 27. Copy of Notice mailed to Circuit Court of Appeals.

Nov. 27. Copy of Notice of Appeal mailed to Attorneys for Appellee.

Nov. 27. Bond on Appeal of the City of Pittsburgh filed.

Dec. 11. On petition order made authorizing the City of Pittsburgh and the Tort Creditors Committee to print in the record on appeal from the order of Court of Oct. 26, 1939, directing the Trustees of the debtor company to pay certain taxes, only the docket entries set forth in Exhibit [fol. 6] "A" attached to petition, in lieu of the docket entries on the record except such other docket entries as the appellees may designate with the approval of the Court.

Dec. 11. Acceptance of service of notice as to printing the record on appeal filed.

Dec. 13. Statement of Appellants' (City of Pittsburgh and the Tort Creditors' Committee) Points on Appeal filed.

Dec. 13. Designation of Contents of Record on Appea (City of Pittsburgh and Tort Creditors' Committee) filed.

Dec. 13. Transcripts of Testimony (2) taken March 28, 1939 at hearing on Petition of Trustees Respecting Taxes and Adjournments thereof, filed.

Dec. 14. Acceptance of service of notice of filing Designation of Contents of Record on Appeal and Statement of Points, filed.

Dec. 22. Recommendations of counsel for trustees relative to Trustees' Petition for Instructions with Respect to Certain Taxes filed.

Dec. 22. Designation of Additional Portions of the Record, proceedings and Evidence to be included in the Record on Appeal and Notice and Acceptance of Service filed.

Dec. 22. Order made directing that the time for filing of the record on appeal with the Clerk of the Circuit Court of Appeals in the appeals of the City of Pittsburgh and the Tort Creditors Committee from an order entered by this Court on Oct. 26, 1939 be extended from Jan. 4, 1940, to Jan. 18, 1940, provided that both the typewritten and printed record be filed on or before Jan. 18, 1940.

Dec. 22. On petition order made directing that there be filed and docketed in the office of the Clerk and made a part of the record in this proceeding the "Recommendation of [fol. 7] Counsel for Trustees Relative to Trustees Petition for Instructions with respect to Certain Taxes" which Blaxter, O'Neill & Houston filed with McVicar, J. personally on or about October 20, 1939, which document does not appear to have heretofore been filed and docketed in the office of the Clerk of this Court. Same day exception noted to City of Pittsburgh and Tort Creditors Committee.

Dec. 29 Stipulation of counsel as to additional portions of the record that shall be printed in the Record on Appeal in the appeals of the City of Pittsburgh and the Tort Creditors' Committee, filed.

IN UNITED STATES DISTRICT COURT

ORDER RE DOCKET ENTRIES

At Pittsburgh, in said District, this 11 day of December, 1939.

The foregoing petition having been presented in open

court, upon due consideration and on motion of counsel, leave is hereby granted to the City of Pittsburgh and the Tort Creditors Committee to print in the record on appeal from the order of court of October 26, 1939, directing the Trustees of Pittsburgh Railways Company, debtor within named, to pay certain taxes, only the docket entries set forth in Exhibit "A" attached to said petition, in lieu of the docket entries on the record except such other docket entries as the appellees may designate with the approval of the court.

By the Court, V.

[fol. 8] IN UNITED STATES DISTRICT COURT

PETITION OF TRUSTEES OF PITTSBURGH RAILWAYS COMPANY, DEBTOR, AND PITTSBURGH MOTOR COACH COMPANY, SUBSIDIARY, PRAYING FOR INSTRUCTIONS WITH RESPECT TO CERTAIN TAXES OF THE DEBTOR AND THE SUBSIDIARY—Filed March 10, 1939

To the Honorable, the Judges of Said Court:

The petition of W. D. George, Thomas M. Benner and Thomas Fitzgerald respectfully represents:

Pittsburgh Railways Company, Debtor

1. Your petitioners were, by Order of Court made June 14, 1938, appointed Trustees for Pittsburgh Railways Company, debtor, and they duly qualified and are now acting as such Trustees.

2. The said Order of Court made June 14, 1938 authorized your petitioners, inter alia, "to preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the Debtor, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues and profits of said property and estate; * * * to pay all taxes and assessments due or to become due upon the property in possession of and/or owned by the Debtor."

3. At the time your petitioners were appointed Trustees for the debtor, the debtor was, and for many years prior

thereto had been, in possession of the street railway or in-
[fol. 9] cline plane properties of approximately 55 separate companies, hereinafter referred to as underliers, which properties the debtor managed and operated, in conjunction with the properties which the debtor owned, as the Pittsburgh Railways Company transportation system.

A list of said underliers is shown on Schedule A hereto attached.

4. The said underliers' properties were in the possession of the debtor under and pursuant to leases or operating agreements. The properties of approximately 80% of the underliers were in the possession of the debtor under either that certain Operating Agreement between Pittsburgh Railways Company and United Traction Company dated January 1, 1902 or that certain Operating Agreement between Pittsburgh Railways Company and Consolidated Traction Company dated January 1, 1902.

Said leases and operating agreements required Pittsburgh Railways Company to pay, inter alia, the taxes of the underliers, and prior to the institution of the reorganization proceedings, Pittsburgh Railways Company paid all taxes of the underliers, including taxes of the kind hereinafter referred to.

The following provision with respect to payment of taxes appears in the said Operating Agreement between Pittsburgh Railways Company and United Traction Company, and the identical provision also appears in the said Operating Agreement between Pittsburgh Railways Company and Consolidated Traction Company except the word "Consolidated" appears in place of the word "United":

"Pittsburgh (Pittsburgh Railways Company) agrees to pay all expense of operation and ordinary maintenance of the lines of railway leased, owned and operated by United; [fol. 10] also to pay all State, County or Municipal taxes assessed against United or which by any present or future law or by contract United may be required to pay; * * *"

Your petitioners are informed and believe that said United Traction Company was required by contract to pay, with respect to the underliers in the so-called United Traction Group, taxes of the kind hereinafter referred to, and Consolidated Traction Company was required by contract to pay, with respect to the underliers in the so-called Con-

solidated Traction Group, taxes of the kind hereinafter referred to.

5. Your petitioners have neither affirmed nor disaffirmed any of the leases or operating agreements under and pursuant to which the properties of the underliers came into the possession of the debtor.

6. The debtor and each of the underliers listed on Schedule A are required to file with the Commonwealth of Pennsylvania, on or before March 15, 1939, a Capital Stock Tax Report for the calendar year 1938, pursuant to the provisions of the Act of June 1, 1889, P. L. 420, as amended (72 PS, 1871).

The tax due on said report is payable when the report is due. (Act of April 9, 1929, P. L. 343, as amended—72 PS, 707.)

7. The debtor and each of the underliers listed on Schedule A are required to file with the Commonwealth of Pennsylvania, on or before March 15, 1939, a Corporate Loans Tax Report for the calendar year 1938, pursuant to the provisions of the Act of June 30, 1885, P. L. 193, as amended (72 PS, 2162).

[fol. 11] The tax due on said report is payable when the report is due. (Act of April 9, 1929, P. L. 343, as amended —72 PS, 708.)

8. The debtor and each of the underliers listed on Schedule A are required to file with the Commonwealth of Pennsylvania, on or before April 15, 1939, a Corporate Net Income Tax Report for the calendar year 1938, pursuant to the provisions of the Act of May 16, 1935, P. L. 208, as amended (72 PS, 3420a).

One-half of the tax due on this report is payable when the report is due and the balance within thirty days after the report is due.

9. The aforesaid Capital Stock tax, Corporate Loans tax and Corporate Net Income tax bear interest at the rate of 6% per annum from the date they are respectively due until sixty days after settlement, and thereafter at the rate of 12% per annum until paid. (Act of April 9, 1929, P. L. 343, as amended—72 PS, 806.)

10. The debtor and each of the underliers listed on Schedule A are required to file, on or before March 15, 1939, a

Federal Income Tax Return for the calendar year 1938, pursuant to the provisions of the Federal Revenue Act of 1938. The tax becomes due March 15, 1939 but may be paid in quarterly installments beginning with that date; and in the event of default in payment of any installment, the entire balance of tax becomes immediately due and payable and bears interest at the rate of 6% per annum from the date of default.

11. The amounts of the aforesaid Pennsylvania Capital Stock tax, Corporate Loans tax, Corporate Net Income tax and Federal Income tax, due by the debtor and each of the underliers, as computed in accordance with the valuations [fol. 12] used for the calendar year 1937, are shown on Schedule A.

12. The Corporate Loans tax shown on Schedule A to be due by the debtor and certain of the underliers, in the total amount of $28,717.35, is based upon interest paid by Pittsburgh Railways Company, prior to May 10, 1938, on its obligations and those of the underliers, and interest paid by your petitioners, subsequent to May 10, 1938, on the debtor's Car Trust Certificates. Of said total tax of $28,717.35, the amount of $772.00 represents the tax based on interest paid by your petitioners subsequent to May 10, 1938 on the debtor's Car Trust Certificates. Of said total tax of $28,717.35, the sum of $484.00 represents moneys withheld from the holders of the obligations for the purpose of paying the tax, and of said amount of $484.00 the sum of $182.00 represents the moneys withheld by petitioners in connection with the interest paid by them subsequent to May 10, 1938 on the debtor's Car Trust Certificates.

13. The Act of April 9, 1929, P. L. 343 (72 PS, 1401), the Fiscal Code, as last amended by the Act of June 11, 1935, P. L. 303 (72 PS, 1401), provides, in part:

"All State taxes imposed under the authority of any law of this Commonwealth, now existing or that may hereafter be enacted, and unpaid bonus, interest, penalties, and all public accounts settled against any corporation, association, or person, shall be a first lien upon the franchises and property, both real and personal, of such corporation, association, or person, from the date of settlement, and whenever the franchises or property of a corporation, association, or person shall be sold at a judicial sale, all taxes, interest,

bonus, penalties, and public accounts due the Commonwealth [fol. 13] shall first be allowed and paid out of the proceeds of such sale before any judgment, mortgage, or any other claim or lien against such corporation, association, or person * * *"

Taxes due the Commonwealth of Pennsylvania have, by statute, been made a lien on the taxpayer's properties from as early as the Act of 1811, 5 Sm. L. 228, Section 12, and the provisions of that section have remained in force and, with revisions, were carried into Section 1401 of the Fiscal Code aforesaid.

14. Substantially all the properties of the debtor and substantially all the properties of each underlier are subject to the lien of one or more mortgages, but none of said mortgage liens, so far as known by your petitioners, was created prior to the enactment of the aforesaid Act of 1811.

15. The Act of Congress of June 18, 1934, c. 585 (28 U. S. C. A. 124a), provides, in part, as follows:

"Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation * * *"

16. For the calendar year 1939 the debtor will be required to file periodic reports and pay the taxes becoming due thereon pursuant to the Pennsylvania Unemployment Compensation Law, approved Dec. 5, 1936 (1937, P. L. 2897; 43 PS, 751), and pursuant to Titles VIII and IX of the Fed- [fol. 14] eral Social Security Act of August 14, 1935 (42 U. S. C. A. 1001 and 1101).

Payments under the State Unemployment Compensation Law and payments under the Federal Old Age Benefits tax (Title VIII) are due quarterly on the last day of the month following the close of the calendar quarter, and payments under the Federal Unemployment Insurance Tax (Title IX) are due on the last day of the month following the calendar year. Credit is allowed on the last named tax in the amount of 90% of the tax paid under the State Unemployment Compensation Law.

The State Unemployment tax bears interest at the rate of 1% per month from the date it becomes due until paid.

The Federal Old Age Benefits tax and the Federal Unemployment Insurance tax bear interest at the rate of ½ of 1% per month from the date they become due until paid.

The aforesaid taxes, commonly called "Social Security Taxes," are based on wages paid by employers to employes, and under the express provisions of the Acts or rulings thereon, Trustees in Bankruptcy are considered employers for the purposes of the tax. These taxes are in connection with the employes of the debtor—they do not concern the underliers of the debtor.

17. The United States has filed liens against the debtor and certain of the underliers for Federal taxes pursuant to the provisions of Section 3186 of the Revised Statutes (26 U. S. C. A. 1560) as set forth on Schedule B hereto attached. The lien filed against the debtor is with relation to Federal Income taxes due for the years 1930, 1931 and 1932, and the lien filed against certain of the underliers is for Federal Income tax due for the calendar year 1937.

[fol. 15] Said Section 3186 of the Revised Statutes reads as follows:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

18. The United States has filed claims in this proceeding against the debtor for Federal taxes in large amounts.

Section 3466 of the Revised Statutes (31 U. S. C. A. 191) provides, in part, as follows:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied * * *"

19. The following explanation is made of the arrangement of Schedule A. For the purposes of the Federal Income tax (and therefore also for the State Corporate Net

Income tax), a parent street railway company may file a consolidated return for itself and those subsidiaries in which it owns 95% or more of the stock. Schedule A is set up on that basis. Pittsburgh Railways Company owns at least 95% of each of the companies indented under its name on said Schedule; Consolidated Traction Company owns at least 95% of the stock of the companies indented under its name; and so on, throughout the Schedule.

[fol. 16] 20. In a budget for the debtor which your petitioners filed in Court on November 7, 1938 in connection with their application for authorization to make certain renewals, replacements and improvements to the properties in their possession, and which covered the period June 1, 1938 to May 31, 1939, provision was made, in the approximate amount of $66,000, for Pennsylvania Capital Stock tax accruing against the debtor and underliers during the budget period as a tax assignable to street railway operation.

Under "Income Deductions" in said budget are included Federal Income tax in the approximate amount of $127,000, State Income tax in the approximate amount of $54,000, and Corporate Loans tax in the approximate amount of $72,000, but while said items have been accrued for the budget period, provision for the payment thereof under the budget estimate has not been made, as said taxes would only arise and become payable if the Trustees of the debtor should, during the budget period, pay interest on the bonded indebtedness of the debtor and interest and rentals under leases and operating agreements hereinabove referred to.

In the aforesaid budget covering the period June 1, 1938 to May 31, 1939, provision was made, as taxes assignable to street railway operation, for State Unemployment tax and Federal Unemployment tax in the approximate total amount of $163,000; and for Federal Old Age Benefits tax in the approximate amount of $54,000, accruing during the budget period.

21. Petitioners had cash on hand, as of March 8, 1939, in the amount of $1,537,247.46, or sufficient to pay any or all of the taxes hereinabove discussed if petitioners are instructed to make such payments. On May 10, 1938, the date of the filing of the debtor's petition herein, the debtor had cash on hand in the amount of $230,260.00.

[fol. 17] 22. None of the underliers has funds with which to pay any of the taxes herein discussed which are applicable to it.

23. On March 15, 1938, Pittsburgh Railways Company paid the installments of Federal Income tax due March 15, 1938 on the return of Pittsburgh Railways Company and on the returns of the underliers for the calendar year 1937. Your petitioners have not paid nor, to their knowledge, has anyone paid the remaining installments which became due on account of said taxes.

Pittsburgh Motor Coach Company, Subsidiary

24. Your petitioners were, by Order of Court made June 14, 1938, appointed Trustees for Pittsburgh Motor Coach Company, subsidiary, and they duly qualified and are now acting as such Trustees.

25. The said Order of Court made June 14, 1938 authorized your petitioners, inter alia, "to preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the Subsidiary, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues and profits of said property and estate; * * * to pay all taxes and assessments due or to become due upon the property in possession of and/or owned by the Subsidiary."

26. Pittsburgh Motor Coach Company, subsidiary, is required to file with the Commonwealth of Pennsylvania, on or before March 15, 1939, a Capital Stock Tax Report for the calendar year 1938, and the amount of the tax as computed by your petitioners will be the sum of $5.00, as shown on Schedule A. The said tax will become due and payable when the report is due. While the subsidiary will be re-
[fol. 18] quired to file a Corporate Loans Tax Report, Corporate Net Income Tax Report and Federal Income Tax Return, it appears no tax will be due on account of any of them.

27. For the calendar year 1939, Pittsburgh Motor Coach Company, subsidiary, will be required to file periodic reports and pay the taxes becoming due thereon pursuant to the State Unemployment Compensation Law and pursuant to Titles VIII and IX of the Federal Social Security

Act imposing Federal Unemployment Insurance tax and Federal Old Age Benefits tax respectively, as hereinbefore in paragraph 16 more fully referred to.

In a budget for the subsidiary which your petitioners filed in Court on January 30, 1939 in connection with the application of your petitioners, as Trustees of the debtor, to pay operating losses of and to make loan to the subsidiary, and which covered the period June 1, 1938 to May 31, 1939, provision was made under operating expenses and taxes, for State and Federal Unemployment taxes in the approximate amount of $14,500, and Federal Old Age Benefits tax in the approximate amount of $4,800.

28. Prior to May 10, 1938, the date of filing of the debtor's petition herein, Pittsburgh Motor Coach Company became liable for the payment of Federal Old Age Benefits tax for the quarter ending March 31, 1938, imposed pursuant to Sections 801 and 804 of Title VIII of the Social Security Act of August 14, 1935 (42 U. S. C. A. 1001 and 1004). In payment of said tax, on or about April 27, 1938, Pittsburgh Motor Coach Company issued to the Collector of Internal Revenue its check in the amount of $1,798.53, but the said check was not presented for payment prior to May 10, 1938, and when the same was presented payment thereof was refused. Thereafter, on July 28, 1938, your petitioners, as Trustees for Pittsburgh Motor Coach Company, subsidiary, paid the tax on employes imposed [fol. 19] under Section 801 of said Act in the amount of $899.26, for the reason that said amount had been deducted from wages paid to the employes, but your petitioners did not pay, and have not paid, the tax on the employer imposed under Section 804 of said Act, and the said tax in the amount of $899.26 remains unpaid. The said tax bears interest at the rate of ½ of 1% per month from the date the tax became due until paid.

29. The United States has filed a lien against the subsidiary, pursuant to the provisions of Section 3186 of the Revised Statutes (26 U. S. C. A. 1560), for Federal Income taxes for the years 1930, 1931 and 1932, as set forth on Schedule B.

30. The United States has filed claims in this proceeding against the subsidiary for Federal taxes in large amounts.

31. Petitioners, as Trustees of the subsidiary, had cash on hand, as of March 8, 1939, in the amount of $32,979.67, or

sufficient to pay any or all of the taxes hereinabove discussed, applicable to the subsidiary, if petitioners are instructed to make such payments. On May 10, 1938, the date of the filing of the subsidiary's petition herein, the subsidiary had cash on hand in the amount of $29,558.00.

Wherefore, your petitioners, being in doubt as to whether or not they should pay any or all of the taxes hereinabove discussed, respectfully pray your Honorable Court to instruct them as to what action they should take with respect to payment of the following:

Debtor and Underliers:

(a) Pennsylvania Capital Stock tax of the debtor for the calendar year 1938.

[fol. 20] (b) Pennsylvania Corporate Loans tax of the debtor for the calendar year 1938.

(c) Pennsylvania Corporate Net Income tax of the debtor for the calendar year 1938.

(d) Federal Income tax of the debtor for the calendar year 1938.

(e) Pennsylvania Unemployment Insurance tax, Federal Unemployment Insurance tax and Federal Old Age Benefits tax of the debtor for the calendar year 1939.

(f) Pennsylvania Capital Stock taxes of the underlying companies in the debtor's transportation system for the calendar year 1938.

(g) Pennsylvania Corporate Loans taxes of the underlying companies in the debtor's transportation system for the calendar year 1938.

(h) Pennsylvania Corporate Net Income taxes of the underlying companies in the debtor's transportation system for the calendar year 1938.

(i) Federal Income taxes of the underlying companies in the debtor's transportation system for the calendar year 1938.

(j) Unpaid balance of Federal Income tax of the debtor for the calendar year 1937.

(k) Unpaid balances of Federal Incomes taxes of certain underlying companies in the debtor's transportation system for the calendar year 1937.

Pittsburgh Motor Coach Company, Subsidiary:

(l) Pennsylvania Capital Stock tax of the subsidiary for the calendar year 1938.

(m) Pennsylvania Unemployment Insurance tax, Fed-
[fol. 21] eral Unemployment Insurance tax and Federal Old Age Benefits tax of the subsidiary for the calendar year 1939.

(n) Federal Old Age Benefits tax (employer's share) of the subsidiary which became due and payable April 30, 1938 for the quarter ending March 31, 1938.

W. D. George, Thomas M. Benner, Thomas Fitzgerald, Trustees.

[fol. 22–24]

EXHIBIT "A" TO PETITION

Pittsburgh Railways Company System

Statement of Federal and State Tax Liability for the Year 1938
To Be Paid in the Year 1939

2—242-243

Pittsburgh Railways Company and Subsidiary and Affiliated Street Railway Companies (controlled through stock ownership)	Actual Liability		Estimated Liability	
	State Capital Stock Tax	State Corporate Loans Tax See Note A	Federal Income Tax	State Income Tax
Pittsburgh Railways Company	$5.00	$11,214.79(B)	None	None
Allegheny, Bellevue and Perrysville Railway Company	5.00	None	"	"
The Allenport and Roscoe Electric Street Railway Company	5.00	"	"	"
Ben Avon and Emsworth Street Railway Company	5.00	"	"	"
Bon-Air Street Railway Company	5.00	"	"	"
Cedar Avenue Street Railway Company	5.00	"	"	"
East McKeesport Street Railway Company	5.00	"	"	"
Glenwood and Dravosburg Electric Street Railway Company	5.00	"	"	"
The McKeesport and Reynoldton Passenger Railway Company	5.00	"	"	"
Mt. Washington Street Railway Company	5.00	"	"	"
Mt. Washington Tunnel Company	5.00	"	"	"
Pittsburgh, Allegheny, and Manchester Passenger Railway Company	5.00	"	"	"
The Pittsburgh, Allegheny and Manchester Traction Company	5.00	64.60	"	"
Pittsburgh & Charleroi Street Railway Company	5.00	None	"	"
Pittsburgh and West End Railway Company	5.00	"	"	"
Pittsburgh, Canonsburg and Washington Railway Company	5.00	934.80	"	"
Pittsburgh, Crafton and Mansfield Street Railway Company	5.00	60.80	"	"
Pittsburgh, Neville Island and Coraopolis Railway Company	5.00	None	"	"
Pittsburgh Union Passenger Railway Company	5.00	"	"	"
Second Avenue Passenger Railway Company	5.00	"	"	"
Second Avenue Traction Company	5.00	433.20	"	"
The Second Avenue Traction Company	5.00	None	"	"
Superior Avenue and Shady Avenue Street Railway Company	5.00	"	"	"
United Traction Company of Pittsburgh	5.00	6,408.89	"	"
Washington and Canonsburg Railway Company	5.00	1,266.80	"	"

17

EXHIBIT "A" TO PETITION—Continued

Pittsburgh Railways Company System

Statement of Federal and State Tax Liability for the Year 1938
To Be Paid in the Year 1939

Pittsburgh Railways Company and Subsidiary and Affiliated Street Railway Companies (controlled through stock ownership)	Actual Liability		Estimated Liability	
	State Capital Stock Tax	State Corporate Loans Tax See Note A	Federal Income Tax	State Income Tax
West End Traction Company	$5.00	$3,069.32	"	"
West Liberty and Suburban Street Railway Company	5.00	832.20	"	"
West Shore Electric Street Railway Company	5.00	None	"	"
Consolidated Traction Company	16,062.35	"	"	"
Ardmore Street Railway Company	5.00	1,163.84	"	"
Central Passenger Railway Company	5.00	34.20(C)	"	"
The Central Traction Company	1,873.16	13.30	"	"
Fort Pitt Traction Company	5.00	None	"	"
The Pittsburgh Traction Company	4,187.50	22.80	"	"
The Duquesne Traction Company	1,499.27	171.00	944.50	443.63
The Duquesne Street Railway Company	5.00	None	None	None
Federal Street and Pleasant Valley Passenger Railway Company	2,683.75	2,486.26	409.82	145.17
The Morningside Electric Street Railway Company	5.00	None	None	None
Seventeenth Street Incline Plane Company	5.00	"	"	"
Total Inside Control	$26,476.03	$28,176.80	$ 1,354.32	$588.80
Other Street Railway Companies, a Majority of Whose Stock is Held by Outside Interest (operated by lease)				
Allegheny Traction Company	$985.31	None	$1,778.31	$802.17
Millvale, Etna and Sharpesburgh Street Railway Company	5.00	$3.80	None	None
The Citizens Traction Co.	7,495.64	38.00	232.25	113.80
Penn Street Railway Company	5.00	59.85	None	None
Monongahela Street Railway Company	17,500.00	None	27,447.50	9,577.10

Mount Oliver Incline Railway Company	375.00	157.70	109.25	53.53
Pittsburgh and Birmingham Traction Company	7,482.59	22.80	12,941.80	4,525.82
The Birmingham, Knoxville and Allentown Traction Company	5.00	None	None	None
Brownsville Avenue Street Railway Company	5.00	"	"	"
Pittsburgh and Birmingham Passenger Railroad Company	5.00	"	"	"
The South Side Passenger Rail Road Company	5.00	15.20	"	"
West Liberty Street Railway Company	5.00	None	"	"
Pittsburgh Incline Plane Company	800.00	"	2,085.95	934.46
The Suburban Rapid Transit Street Railway Company	3,150.00	243.20	4,912.00	1,740.04
Total Outside Control	$37,823.54	$540.55	$49,507.06	$17,746.92
Grand Total	$64,299.57	$28,717.35	$50,861.38	$18,335.72
Pittsburgh Motor Coach Company	$5.00	None	None	None

Notes "A" Denotes liability for Corporate Loans Tax on bond interest paid by Pittsburgh Railways Company.
"B" A portion of this tax was withheld from coupon interest payments to taxable holders of Pittsburgh Railways Co. Car Trust 6% Series B Gold Bonds.
"C" All of the tax on Central Passenger Railway Company First Mortgage 6% Bonds was withheld from interest payments to the taxable holders.

Accounting Department,
Pittsburgh, Pa.
March 8, 1939.

Duly sworn to by Thomas Fitzgerald. Jurat omitted in printing.

[fol. 25] SCHEDULE "B" TO PETITION

Liens

Filed by the United States against Pittsburgh Railways Company, debtor, certain of its underlying companies and Pittsburgh Motor Coach Company, subsidiary.

Pittsburgh Railways Company—

Income Tax Lien No. 3528 assessed 6/29/38 for years 1930-31-32 in amount of $5,771,066.22; filed 7/19/38.

The Duquesne Traction Company & Affiliated Corp.—

Income Tax Lien No. 3565 assessed 7/14/38 for year 1937 in amount of $1,251.40; filed 8/4/38.

Federal Street and Pleasant Valley Passenger Railway Company—

Income Tax Lien No. 3564 assessed 7/14/38 for the year 1937 in amount of $3,451.20; filed 8/4/38.

Monongahela Street Railway Company—

Income Tax Lien No. 3567 assessed 7/14/38 for year 1937 in amount of $40,624.39; filed 8/4/38.

Pittsburgh and Birmingham Traction Company—

Income Tax Lien No. 3568 assessed 7/14/38 for year 1937 in amount of $18,852.05; filed 8/4/38.

Pittsburgh Incline Plane Company—

Income Tax Lien No. 3563 assessed 7/14/38 for year 1937 in amount of $1,383.71; filed 8/4/38.

[fol. 26] The Suburban Rapid Transit Street Railway Company—

Income Tax Lien No. 3569 assessed 7/14/38 for year 1937 in amount of $6,405.00; filed 8/4/38.

Pittsburgh Motor Coach Company—

Income Tax Lien No. 3529 assessed 6/29/38 for years 1930-31-32 in amount of $5,771,066.22; filed 7/19/38.

IN UNITED STATES DISTRICT COURT

ORDER OF REFERENCE

And now, to-wit, March 10, 1939, the foregoing petition of W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary, having been presented in open Court, upon consideration thereof and on motion of Blaxter, O'Neill & Houston, counsel for petitioners, it is ordered, adjudged and decreed that said petition be and it is hereby referred to Watson B. Adair, Special Master, for a hearing and report thereon; that said hearing be held by the said Special Master on March 28, 1939 at 10:30 o'clock A. M., at Court Room No. 6, Sixth Floor, Federal Building, Grant Street, corner Seventh Avenue, Pittsburgh, Pennsylvania; that ten days' notice of the time and place of such hearing be given by mail to Pittsburgh Railways Company, debtor, and Pittsburgh Motor Coach Company, subsidiary, their creditors, claimants, stockholders and indenture trustees, their subsidiaries and affiliated companies and indenture trustees under their issues, the Securities and Exchange Commission, the Secretary of the Treasury, and all other persons interested in the within reorganization proceeding whose names appear on the books and records of the debtor and its subsidiary; [fol. 27] that a hearing on the petition and report of the Special Master, and on any exceptions filed thereto, be held by a Judge of this Court on the fifth day following the date of filing said report, excluding the date on which it is filed; and that notice of such hearing by a Judge shall be included in the notice to be given of the hearing before the Special Master.

By the Court, V.

[fol. 28] IN THE UNITED STATES DISTRICT COURT

OBJECTIONS OF THE TORT CREDITORS COMMITTEE TO PAYMENT OF TAXES OR TAX ITEMS SET FORTH IN THE PETITION OF THE TRUSTEES FILED MARCH 10, 1939—Filed April 14, 1939

To the Honorable, the Judges of said Court:

The Tort Creditors Committee at the hearing held the 28th day of March, 1938, before the Special Master, re-

serving the right to interpose further and additional objections, formally objected by notation on the record to the payment by the trustees of the several taxes due from the underlying companies in the Pittsburgh Railway System, for the following reasons:

1. That the taxes are the taxes of the underliers and not of the Pittsburgh Railway Company. That if the Railways is liable for such taxes it is because of a contractual obligation to the underliers and not by reason of any direct liability as a taxpayer to the United States Government or the Commonwealth of Pennsylvania therefor.

2. That no order authorizing the payment of taxes due from the underliers should be made unless and until the underliers are made parties to the proceeding. An application has been made to the Court to bring a number of the underliers into the proceeding and until this application is disposed of, nothing should be done relative to the payment of these taxes by the Pittsburgh Railways System. [fol. 29] The said Committee, by its undersigned counsel, further object to the payment of the taxes or tax items set forth in the prayer of the aforesaid petition for the following additional reasons:

3. It does not appear that there is any emergency or other immediate necessity for the payment of the tax items or tax claims due from the underliers in advance of the usual and ordinary times of payment in the reorganization proceeding—that is to say, at the time of or after the confirmation of the plan.

4. There is nothing in the petition to show particular or legal justification for the payment, at this time, of any of the tax items of the underliers.

A. E. Kountz, Lewis M. Alpern, Attorneys for Tort Creditors Committee and Attorneys of Record for Various Creditors.

[fols. 30-31] IN UNITED STATES DISTRICT COURT

Excerpts from Transcript of Testimony Taken at Hearings Before the Special Master

(Transcript filed August 22, 1939)

Hearing March 28, 1939, before Watson B. Adair, as Special Master, on Petition of Trustees filed March 10, 1939, Respecting Taxes

APPEARANCES:

For the Trustees: Blaxter, O'Neill & Houston, Esqs., by Messrs. Houston and O'Neill.
For Citizens Traction Company: Lee C. Beatty, Esq.
For Tort Creditors' Committee: Lewis M. Alpern, Esq.
For Allegheny Traction Company, Millvale, Etna & Sharpsburg St. Ry. Co.: Hill Burgwin, Esq.

[fol. 32] OBJECTIONS TO TORT CREDITORS' COMMITTEE

MR. ALPERN:

The Tort Creditors' Committee, reserving the right to interpose further and additional objections, objects to the payment by the Trustees of the several taxes due from underlying companies of the Pittsburgh Railways System, for the following reasons:

First: That the taxes are the taxes of the underliers and not of the Pittsburgh Railways Company; that if the Railways Company is liable for such taxes, it is because of contractual obligation to the underliers, not by reason of any direct liability as a taxpayer to the United States Government or to the Commonwealth of Pennsylvania.

Second: That no order authorizing the payment of taxes due from the underliers should be made unless and until the underliers are made parties to the proceeding. An application has been made to the Court to bring a number of the underliers into the proceeding, and until this application has been disposed of nothing should be done relative to the payment of these taxes by the Pittsburgh Railways System.

Adjournment to April 14, 1939.

[fol. 33] Hearing April 14, 1939, before Watson B. Adair, Special Master, Pursuant to Adjournment from March 28, 1939, on Trustees' Petition for Instructions with Respect to Certain Taxes

Present:

For Trustees: Blaxter, O'Neill & Houston, Esqs., by Mr. O'Neill.
For Citizens Traction Company: Lee C. Beatty, Esq.
For Philadelphia Company: W. W. Booth, Esq., and W. A. Seifert, Esq.
For Allegheny Traction Company: Hill Burgwin, Esq.
For Tort Creditors' Committee: Lewis M. Alpern, Esq. and A. E. Kountz, Esq.
For Bureau of Internal Revenue: John D. Ray, Esq. and John E. Shea, Esq.
For City of Pittsburgh: R. B. Tucker, Jr., Esq.
Mr. Thomas Fitzgerald, one of the Trustees appeared, the other two trustees not being present.

* * * * * * *

C. T. Harmon, a witness called on behalf of the Trustees, being duly sworn, testified as follows:

Direct examination.

By Mr. O'Neill:

Q. Mr. Harmon, you are employed by the Trustees of the Pittsburgh Railways Company?
[fol. 34] A. Yes, sir.
Q. In what capacity are you employed?
A. Chief Accountant of the Statistical Division.

Mr. O'Neill: I wish to state to the Master that instructions were requested with respect to what should be done as to the payment of unpaid balances of Federal Income Taxes for the calendar year 1937, and the same taxes of certain underliers for the calendar year 1937, this appearing as Items (j) and (k) on pages 12 and 13 of the petition. However, the amount of the balances of these taxes are not stated and that I would like to get on the record.

(A paper marked as Trustees' Exhibit No. 1)

Mr. O'Neill:

Q. Mr. Harmon, there is no unpaid balance of Federal Income Tax for the Pittsburgh Railways Company for the year 1937?

A. That is correct.

Q. However, there is a balance owing on account of those taxes by certain underliers for those years?

A. That is right.

Q. At my request did you prepare a schedule of the amount of those taxes?

A. That is right.

Q. I show you a paper marked "Trustees' Ex. No. 1" and ask you if there is shown in that in the first column the unpaid balances of the Federal Income Tax for the calendar year 1937 of the underlying companies?

A. That is correct. The payments were due June 15, September 15 and December 15, 1938.

[fol. 35] The Master: Do I understand that this exhibit refers to paragraph (k) of the petition?

Mr. O'Neill: Paragraphs (j) and (k). Another tax we would like to have considered in connection with this application is the State Corporate Net Income Tax for the calendar year 1937. Mr. Seifert's comments so far as that state income tax is concerned were directed to the year 1938. No mention has been made in the petition of that tax for the calendar year 1937.

Q. Mr. Harmon, there is no balance of state corporate income tax due for the year 1937 by the Pittsburgh Railways Company?

A. No, there is no tax liability for Pittsburgh Railways Company.

Q. Did you at my request prepare a schedule of the unpaid state corporate net income tax due by the underlying companies for the year 1937?

A. Yes, sir.

Q. That tax for the year 1937 is payable when and how?

A. It is payable in semi-annual installments, April 15 and September 15, 1938.

Q. Of the year 1938?

A. 1938.

Q. Has the April 15, 1938 installment been paid?

A. It has been paid.

Q. I show you again the paper marked Trustees' Exhibit No. 1, and ask you if in the second column is shown the unpaid installment of the 1937 state corporate net income taxes due by the underliers in the year 1938?

A. That is correct.

[fol. 36] Q. In other words, the next installment would be payable May 15, 1938?

A. That is correct.

Mr. O'Neill: I offer in evidence Trustees' Exhibit No. 1.

The Master: Mr. Seifert, are the 1937 taxes subject to the same objections as the 1938 taxes?

Mr. Seifert: Precisely so, yes, sir.

E. C. Donaghy, a witness called on behalf of the Trustees, being duly sworn, testified as follows:

Direct examination.

By Mr. O'Neill:

Q. Mr. Donaghy, you are employed by the Trustees of Pittsburgh Railways Company?

A. I am.

Q. In what capacity, Mr. Donaghy?

A. As chief of the Bond Records Division.

Q. Two other taxes we would like to have considered in connection with this petition of the Trustees are the federal income taxes withheld for the years 1937 and 1938, those taxes arising in connection with the covenants in bond issues whereby the obligor agrees to pay 2% of the income tax of the obligee on account of the income from those bonds?

A. Correct.

(A paper marked for identification as Trustees' Exhibit 2.)

[fol. 37] Q. Mr. Donaghy, you have prepared at my request a schedule of the taxes withheld or paid at source by Pittsburgh Railways Company and the underlying companies in connection with their bonds issued for the year 1937?

A. I did.

Q. I show you a paper marked Trustees' Exhibit No. 2, and ask you if that schedule appears in the first column shown on that exhibit?

A. That is correct.

The Master: Schedule of what?

Mr. O'Neill: Schedule of the amount of taxes in connection with interest paid on tax free covenant bonds of the Debtor and underlying companies during the year 1937.

The Master:

Q. What is your answer, Mr. Donaghy?

A. That is correct, yes, sir.

Mr. O'Neill: This is just for 1937. He is speaking of the first column.

The Master:

Q. As I understand, the first column indicates the tax which the Pittsburgh Railways Company or the respective underlier assumed and agreed to pay with respect to interest which was paid during the year 1937, is that right?

A. Yes, sir.

Mr. O'Neill:

Q. Does this exhibit, in the second column show the some situation with respect to the year 1938?

A. It does, sir.

[fol. 38] Q. The tax shown for the year 1937, $9,832.53, is payable when?

A. June 15, 1938.

Q. And the tax shown for the year 1938, $4,203.75, is payable when?

A. It will become due on June 15, 1939.

The Master:

Q. Are these amounts based on interest which was actually paid, or merely interest or partly interest which was deposited with disbursing agencies, whether it was paid out or not?

A. Those would represent only those items where the interest was actually paid.

Mr. O'Neill: We offer in evidence Exhibit No. 2.

Q. Mr. Donaghy, you are familiar with the state corporate loan taxes of the Debtor and the underliers, is that correct?

A. Yes, sir.

Q. The reports due by the underliers are filed by the underliers, is that correct?

A. That is correct.

Q. And the settlement for the tax by the Department of Revenue is made against the underlier in each particular case, is that correct?

A. That is correct.

Q. But remittance for the tax has been made by Pittsburgh Railways Company by its check, is that correct?

A. That is correct.

Q. The Pittsburgh Railways Company paid the interest which produced the corporate loan tax, at least prior to May 10, 1938, the time the reorganization proceeding began?

[fol. 39] A. It was deposited on their check, yes, sir.

Q. Do I understand you to say that amounts to cover the interest deposits were deposited by Pittsburgh Railways Company by its own check?

A. Yes, sir.

Q. And that was the money used to pay the installments?

A. Yes, sir.

The Master:

Q. Where was that deposited?

A. With paying agencies.

Q. What amounts with reference to the amount of interest due, did the Pittsburgh Railways Company deposit? That is, did it deposit the face amount of the interest due?

A. It deposited the face amount of the interest which was due.

Q. Do you know whether all the bonds contained provisions that the obligor was to pay the interest without deduction for state tax, or did it vary?

A. They varied. Their mortgage would vary.

Q. Where the debtor would not agree to pay for redemption, did the Pittsburgh Railways Company still deposit the face amount of the interest?

A. Yes, sir.

Q. Then when the deposit was made, what became of the amount returned?

A. That was returned to the Pittsburgh Railways Company by the paying agents.

Q. Were those returns to the Pittsburgh Railways Company made before May 10, 1938?

A. Yes, sir.

Q. All of them?

A. The return of the state corporate loan deducted by the paying agent, that was returned before May 10. How-
[fol. 40] ever, there is an item involved in the Pittsburgh Railways Company where it was not, having been deducted from interest deposited by the Trustees.

Q. Do you know how much that is?

A. No, sir. I believe it is included in Mr. O'Neill's petition. I don't recall the specific amount of it.

Mr. O'Neill:

Q. You are referring to amounts actually withheld?

A. Yes, sir.

Q. That shows in the petition prior to May 10, 1938 and after, in connection with Car Trust Certificates, is that correct?

A. That is correct.

Mr. O'Neill: That appears on page 4, paragraph 12.

I now offer in evidence the petition filed by the Trustees which has been the subject of this hearing.

* * * * * * *

HEARING ON TRUSTEES' PETITION WITH RESPECT TO CERTAIN TAXES, RESUMED JUNE 9, 1939, PURSUANT TO ADJOURNMENT FROM MAY 25, 1939

Present:

For Trustees: J. Henry O'Neill, Esq., of Blaxter, O'Neill & Houston, Esqs.; Messrs. George and Fitzgerald, Trustees.

For Citizens Traction Company: Richard W. Ahlers, Esq.

For Philadelphia Company: W. A. Seifert, Esq.

[fol. 41] For City of Pittsburgh: R. B. Tucker, Esq.

For Securities and Exchange Commission: Marland Gale, Esq.

For Committee for Municipalities' Interests: Walter M. Newman, Esq.

D. C. DONAGHY, a witness called on behalf of the Trustees, being duly sworn, testified as follows:

Direct examination.

By Mr. O'Neill:

Q. Mr. Donaghy, you are employed by the Trustees of the Pittsburgh Railways Company?

A. I am.

Q. In what capacity?

A. As Chief of the Bond Tax Bureau.

Q. And you were employed by the Philadelphia Company and its affiliated companies prior to the time of your employment by the Trustees?

A. That is correct.

Q. And I imagine you are still employed by the Philadelphia Company and its affiliated companies, besides the Pittsburgh Railways Company and Pittsburgh Motor Coach Company?

A. That is right.

Q. Are you familiar with the method and manner of paying the Pennsylvania corporate loans tax that was in effect prior to May 10, 1938?

A. I am.

Q. Will you state what the mechanical steps were in [fol. 42] connection with that tax? In other words, how was the interest paid?

A. Deposited or paid. Deposited by a voucher drawn by the Pittsburgh Railways Company, in the event of underlying companies, with the paying agent. The instructions regarding deductions for corporate loan tax were that any such taxes were to be deducted from the holders.

Q. And such a tax would be deducted from the holders if there was a limit on the obligation of the issuer of the bonds?

A. That is correct.

Q. You say the paying agents in cases where a deduction was to be made. You withheld that amount of taxes from the bondholders?

A. From the taxable bondholders.

Q. Then what would become of that money?

A. That money at the close of the month would be returned to the company marked "Pennsylvania Tax deducted from taxable residents of the state."

Q. Do you mean deducted by the paying agent?

A. That is correct.

The Master:

Q. You say it was returned at the end of the month. What month?

A. At the end of the month in which the coupon to be taxed matured. It is customary for the paying agent to make a monthly return.

Q. Would they withhold the money until all the coupons were in?

A. No, sir. They would hold it until the close of the month. It is not usual for all the coupons to be presented in the same month in which they mature.

Q. Then they returned the tax deductions which were made that month?

[fol. 43] A. Yes, sir.

Q. But the balance of the money available for the interest is held by the paying agent?

A. Until the payment is made, yes, sir.

Mr. O'Neill:

Q. With respect to the corporate loans tax for the year 1938, can you tell us how much tax was withheld from bondholders on account of interest that was paid by the Pittsburgh Railways Company prior to May 10, 1938?

A. About $302.00.

Q. Now, the practice you have described is the same after May 10, 1938, with respect to interest paid by the Trustees on car trust bonds?

A. That is correct.

Q. What amount of interest in that instance, if any, was actually withheld from the bondholders and marked by the paying agents—marked as described?

A. $182.00.

Q. Now, Mr. Donaghy, you are not familiar with what happened to the checks after they came back to the organization, or to the Trustees?

A. No, sir. That is a Treasurer's Office function.

The Master:

Q. Do the deductions amounting to $302.00 represent deductions from interest owing by the Pittsburgh Railways Company on its own obligations or on interest owing by underlying companies on their obligations?

A. The answer would be that there are two companies involved in that $302, the Central Passenger Railway Company with an amount, I believe of $34.20, and the balance is a deduction from the car trust bonds to the Pittsburgh Railways Company. In respect to that $34.20, that $34.20 represents the amount of tax owing on Central Passenger Railway bonds, after a deduction has been made for the [fol. 44] Treasurer's commission allowed by the State for making collection, but the total amount of tax deducted would have been $36 and would have been so associated in the $302.

Mr. O'Neill:

Q. Mr. Donaghy, turning from state corporate loan tax to federal tax withheld—in other words, income tax withheld at source. Will you explain how that works? As I understand it, no money is actually withheld from bondholders?

A. That is correct. That is a misnomer in there in regard to the taxpayer's taxable status. It represents an indication by the bondholder that he wishes to avail himself of the 2% tax covenant in the mortgage and he so indicates when he prepares the ownership certificate, which he presents with his coupon. That indication is not known to the Company until the certificate of ownership reaches us. After it reaches us it is then included in the monthly return to the Commissioner of Internal Revenue, in which we set forth the name, the address of the owner and the amount of interest he has received and calculate a 2% tax on it. That tax is then accumulated for the entire record for that particular month. At the close of the year we summarize our monthly returns, setting forth in the summarized report only the amount of taxes for each respective month.

That summarized report must be filed on or before March 15 of the year following that for which the returns were filed and we are assessed on the 15th day of June.

Q. Mr. Donaghy, I show you a paper which was offered in evidence as Exhibit No. 2 at the hearing on this tax petition held April 14th, 1939. It is shown on that exhibit that you mean the tax withheld at source for the year 1937 is in the amount of $9,832.53, is that correct?

A. That is correct.

[fol. 45] Q. And that the same tax for the year 1938 is in the amount of $4,203.75?

A. That is correct.

The Master:

Q. That is 1938 paid to when?

A. The entire year for 1938, for which the tax will come due on the 15th of this month.

Q. Were any payments made in 1938 after May 10th?

Mr. O'Neil: The Trustees made payments on the car trust bonds and I believe the Philadelphia Company made payments on its guarantees.

The Witness: That includes payments prior to the trusteeship by the Debtor Company and those car trust securities on which the Trustees paid interest after they went in office.

Mr. O'Neill:

Q. And of the amount of $4,203.75, the $110.40 represents the tax payable at source on interest paid by the Trustees on the car trust bonds?

A. That is correct.

The Master: Q. What does the rest represent?

Mr. O'Neil: It shows the issues on which they were paid, on the exhibit.

The Master:

Q. Can you tell, Mr. Donaghy, how much of this $4,203.75 is derived from interest paid prior to May 10, 1938?

[fol. 46] A. All of it would be, except this $110.40 referred to in Item "C". That would be approximately $4100.

H. D. MEGAHAN, a witness called on behalf of the Trustees, being duly sworn, testified as follows:

Direct Examination.

By Mr. O'Neill:

Q. Mr. Megahan, you are employed by the Trustees of the Pittsburgh Railways Company?

A. I am.

Q. In what capacity?

A. I am Assistant Treasurer, for them.

Q. And you are also employed in the same capacity by the Philadelphia Company and its affiliated companies?

A. I am Assistant Treasurer for the Philadelphia Company and all its subsidiaries.

Q. And I believe you were so employed prior to this reorganization proceeding?

A. I was.

Q. You are familiar with the bank accounts then of the Debtor before May 10, 1938, and of the Trustees subsequent to June 14, 1938?

A. I am.

Q. And you are also familiar, I believe, with the handling of the checks that would be returned from paying agents in connection with corporate loan tax withheld from bondholders?

A. Right.

Q. You heard Mr. Donaghy's testimony with respect to return of those checks?

A. I did.

[fol. 47] Q. When a check would be received by Pittsburgh Railways Company prior to May 10, 1938, covering this remittance of tax from the paying agent, do you know where that check would be deposited?

A. In the Farmers Deposit National Bank, as a general rule.

Q. In what account, a special account, or a general account?

A. In a general account.

Q. Did the Company have a separate account for corporate loan taxes?

A. As far as I know the Company has never carried a special account for tax purposes.

Q. In other words then, the check would be deposited in the general account of the Pittsburgh Railways Company?

A. That is correct.

Q. Mr. Donaghy testified that the amount of tax remitted by paying agents to the Railways Company for the year 1938, the corporate loan tax, was in the amount of about $302. Do you know whether the general account of Pittsburgh Railways Company at the Farmers Deposit National Bank on May 10, 1938, was in excess of $302?

A. Considerably in excess of that amount.

The Master:

Q. Was that account continuously in excess of that amount from the first of January, 1938—in excess of $302—since the first of January, 1938?

A. Since that time and before that time, as far as I know, it has always been substantially in excess of that amount.

Q. Well, you do know?

A. Yes, sir.

[fol. 48] Mr. O'Neill:

Q. Mr. Donaghy testified that the amount of tax withheld from bondholders in connection with interest payments made by the Trustees and returned to them by the paying agents was $182. Do you know in what account that check for those funds would have been deposited by the Trustees?

A. That would go in the same account in the Farmers Deposit National Bank.

Q. Do the Trustees have a special account for corporate loans taxes?

A. They do not.

Q. Can you state whether or not on June 14, 1938, the amount in that account in the Trustees' name was in excess of $182?

A. Substantially in excess of that amount.

Q. And it has continued to be substantially in excess of that amount from June 14, 1938 to date?

A. It has.

Q. During the period from May 10, 1938 to June 14,

1938, or while the Debtor was in possession, did that debtor have a separate corporate loan tax account?

A. It did not.

Q. It did have a general account in the Farmers National Bank, is that correct?

A. That is correct.

Q. And was the balance in that account at all times during that period in excess of $302?

A. It was.

The Master:

Q. I think you said that the remittances were generally put in that account.

A. They were generally put in that account. The Farmers Deposit National Bank is not the only bank, but that [fol. 49] is the main depository for the Company funds of the Trustees.

Q. Was that the account on the first of January, 1938, in which the tax remittances from the paying agents were actually deposited?

A. That is correct.

Mr. O'Neill:

Q. Did either the Pittsburgh Railways Company before May 10, 1938, or the Debtor after May 10, 1938 and before June 14, 1938, or the Trustees subsequent to June 14, 1938, ever have a separate tax account in connection with taxes withheld at source?

A. They have not.

Q. And whenever that tax had been paid by Pittsburgh Railways Company, the funds were drawn on what account?

A. On the account in the Farmers Deposit National Bank always.

Q. The general account?

A. Yes.

The Master:

Q. Were the moneys which were transferred to paying agents for the purpose of paying interest always drawn from any one account?

A. That same account.

Q. Was there always left in that account after transferring funds to the paying agents more than enough to cover this constructive retention of tax?

A. There was.

Q. And did the bank balance always exceed the total of those constructive retentions, plus the tax remittances from the paying agents?

A. It did.

Q. Was all interest paid through paying agents?

[fol. 50] A. Yes, sir.

Mr. O'Neill:

Q. Was the general account in the Farmers Deposit National Bank of Pittsburgh Railways Company, prior to May 10, 1938, and of the Debtor during the period from May 10, 1938 to June 14, 1938, and of the Trustees subsequent to June 14, 1938, always substantially in excess of the sum of $14,000, being the approximate total amount of the Federal tax withheld at source for the years 1937 and 1938?

A. It was.

Q. That is, plus the sum of $484, being the total amount of corporate loans tax deducted from interest paid to bondholders during the year 1938.

A. The answer is still the same—that it was.

Cross-examination.

By Mr. Kountz:

Q. Mr. Megahan, in addition to this money you spoke of, are there any other trust funds of other people in that account, as far as you know, or were there during the period Mr. O'Neill referred to?

A. That is more or of a legal question as to what constitutes trust funds.

Q. What I have in mind is,—there might be a presumption that this money belongs to these taxing authorities, but that there are other possible trust funds in the same account?

A. Trust funds as such, strictly speaking, there were no trust funds in that account. As far as we treated it that was a general account of the Company used for all purposes.

Q. You do not have any reason now to suppose that [fol. 51] anybody else would come in here and claim any of these funds as trust funds, is that correct?

A. I would hesitate to say, because I don't know——

Mr. Seibert: Objected to.

Mr. Kountz: Your Honor, all we are concerned with is whether somebody else might come in here and claim a part of this fund.

The Master:

Q. Do you know of any other possible claims that might be made against this fund as trust funds of any nature?

A. It would depend, of course, on how you treated wages due employees. I don't know how that is treated. That would be a legal question.

Q. It might apply to Social Security taxes retained?

A. If that would be true then it would be in that fund.

Q. In addition to those other taxes?

A. That is correct.

Mr. O'Neill:

Q. Mr. Megahan, will you explain how the sharing of Social Security taxes owed by the employees of the Company is handled in the bank accounts?

A. So far as the bank accounts are concerned, and the payroll accounts, there are special accounts set up periodically called "Paymasters Accounts". In those accounts are deposited just sufficient funds to meet the payroll of that particular period, with the deduction having been made prior to the time the money was deposited in the payroll accounts for any tax due.

Q. In other words, the tax deducted remains in the general account.

[fol. 52] A. That is correct.

Q. And that was the practice of the Railways Company prior to May 10, 1938, and of the Debtor in possession, and is the practice of the Trustees?

A. Yes.

Q. And was the balance in the general account, at the Farmers Deposit National Bank, of the Pittsburgh Railways Company, prior to May 10, 1938 and of the Debtor while it was in possession between May 10, 1938 and June 14, 1938, and of the Trustees subsequent to June 14, 1938,

always substantially in excess of the total amount of the following taxes that were discussed here this morning: Pennsylvania Corporate Loans Tax withheld from interest paid to resident bondholders; Federal Income tax withheld at source for the years 1937 and 1938, and the employees' share of the Federal Old Age Compensation tax?

A. Without knowing the amount of the Federal Old Age Compensation tax, I could not answer that definitely. I could answer it in a general way, by saying that the amount in the general account at the Farmers Deposit National Bank since May 10, 1938, has never been less than $75,000.

Q. And before May 10, 1938?

A. How far before?

Q. Well, at any time during the period from January 1, 1938 to May 10, 1938?

A. On January 3, 1938, the balance in the Farmers Deposit National Bank was $245,000. On May 10, 1938, the balance in the Farmers Deposit National Bank was $108,000, and on June 14, 1938, the balance in the Farmers Deposit National Bank in the general account was approximately $601,000.

The Master:

Q. Well, that doesn't tell us the low points: From Jan-
[fol. 53] uary 1, to May 10, 1938, what was the low point of your deposit?

A. February 28.

Q. How much was it then?

A. $51,000 in the Farmers Bank and total in all depositories of $91,000.

Q. From May 10, 1938 to June 14, 1938, what was your low point in this general account?

A. In the Farmers Bank, without knowing definitely, I would say that May 10th itself was the low point, because at June 14th the account had grown to $601,000.

Q. And after June 14th, 1938?

A. Since June 14, 1938, I think I can safely say it has never dropped below $500,000. I could get you the exact figure and the low date.

Mr. O'Neill:

Q. Mr. Megahan, you are familiar with the amount of the monthly payroll of the Trustees?

A. The approximate amount, yes.

Q. And also the payroll of the Pittsburgh Railways Company before the trusteeship?

A. Yes.

Q. Based on that, are you able to make an estimate of what you think the employees' share of the Federal Old Age Compensation tax would run per month?

A. The payroll of the Pittsburgh Railways Company for sometime has run, I would say, as an estimated payroll, between $450,000 and $520,000 per month.

The Master:

Q. Is that true ever since the first of April, 1938?

A. Yes.

Q. Then the Social Security tax of 1% would not exceed $5300 during a month?

A. That is true. And there was always that amount of [fol. 54] money in the general accounts at the Farmers Deposit National Bank and sufficient to cover any other taxes we have discussed in this proceeding.

THOMAS FITZGERALD, a witness called by Counsel for the Trustees, being duly sworn, testified as follows:

Direct Examination

By Mr. O'Neill:

Q. Mr. Fitzgerald, you are one of the Trustees of the Pittsburgh Railways Company?

A. Yes, sir.

Q. Mr. Fitzgerald, would it be possible to determine the net earnings of the separate underlying companies of the Pittsburgh Railways System, over the period the Company has been in the reorganization proceeding, in other words, from May 10, 1938 to date?

A. No, sir.

Q. Would you state why it would not be possible to do so?

A. I prepared a statement which I would like to read in answer to that question. Since the Pittsburgh Railways System was created in 1902, there has been absolutely no effort to account for revenues and operating expenses of individual underlying companies. The most rational approach to a method of doing so would require an origin and destination stated for each ride taken. An attempt to do

this would be tremendously expensive and would entail so many assumptions as to the allocation of proportions of fares that it could not be used as a dependable basis for allocating revenues to individual companies. To attempt [fol. 55] to apply estimates of operating expenses against any method of estimating earnings, would only accumulate additional assumptions and produce a net earnings estimate which would contain a multiplication of errors and therefore have no meaning. The only way in which the net earnings of each underlier could be determined would be to operate each independently. This would be of no value in our present problems and would be physically and commercially impossible. It would not be satisfactory to the public, or to the municipal and state authorities.

Cross-examination.

By Mr. Seifert:

Q. Mr. Fitzgerald, did you say the Pittsburgh Railways System had been operating as a unified system since 1902?

A. That is my understanding.

Q. Practically all of the underliers were operating back of that period?

A. I would say substantially all of them, yes, sir.

Mr. Alpern:

Q. Mr. Fitzgerald, do you know at the present time whether the Trustees are in a position to advise the Court which properties of the underliers, or the property of which underliers, it is the intention of those responsible for the reorganization of the Company to reject?

Mr. O'Neill:

Mr. Fitzgerald is not one of the Reorganization Trustees. Mr. George and Mr. Benner, the other two Trustees of the Pittsburgh Railways Company, are the ones directed to prepare and file the Plan of Reorganization. In fact, they both are in Court this morning and we intend to put Mr. [fol. 56] George on the stand to say what he can say about the future use of the properties of the underliers.

Mr. Alpern:

I have understood all the time that Mr. Fitzgerald is the operating head of the System and is familiar, no doubt with

the value of the properties, and whether or not certain properties have no value.

Mr. O'Neil:

But Mr. Fitzgerald has no duties whatsoever under the court order and anything Mr. Fitzgerald would say would in a sense be hearsay, compared to what Mr. George would say. I don't object to your question—I want to advise you and also the Master, that the Trustee to whom I think your question should be directed will be put on the stand and will be glad, I know, to answer your question. I merely point out that you are asking your question of the Trustee who has no authority as to what will be done with the Plan.

Mr. Alpern:

Q. Mr. Fitzgerald, you are operation head of the Pittsburgh Railways System?

A. Yes, sir.

Q. And you have been engaged in the operation of the system for how long?

A. Since 1924—as active head of the organization.

Q. And also since the filing of this court proceeding?

A. Yes, sir.

Q. Now, I would like to renew my question.

A. My answer to the question is, No, I do not know.

Mr. Seifert:

Q. Mr. Fitzgerald, have the Trustees either affirmed or disaffirmed any of the leases under which the Pittsburgh [fol. 57] Railways Company operate and did operate prior to the appointment of yourself and two associates as Trustees under 77-B?

A. They have neither affirmed or disaffirmed.

The Master:

Q. Mr. Fitzgerald, do you know any way other than ascertainment of earnings for the determination of fair rental value of the properties of the underlying companies which have been utilized by the Pittsburgh Railways Company or its Trustees since May 10, 1938?

A. I think that question should be answered by the Reorganization Trustees. I at present know of no method of

determining what relative rentals should be paid to the various underlying companies.

Q. You are not prepared then to give any evidence on that question?

A. No, sir. I would have to make a more intensive study of that particular problem than has been made heretofore before I could answer it. At the present time there are not available sufficient net earnings to make that a question.

The Master:

Well, the question is likely to confront the Court in the proceeding.

Mr. Alpern:

Q. Mr. Fitzgerald, since your appointment as one of the Trustees of the Pittsburgh Railways Company in this present proceeding, have you yourself given any thought to, or have you any views with respect to which properties of the Railways Company, or of its leases, should be rejected, and which should be taken up by the Trustees?

A. Inasmuch as we are not making any payments on any of the securities of the underlier companies—the only pay-[fol. 58] ments we are making are on the car trust bonds—the question of the abandonment of these properties would not be immediate. Now, there has been some consideration given to the abandonment of some properties, such as some of the inclines; the possibility was considered of abandoning the interurbans, but in the case of the interurbans if we had abandoned them—say last May—our estimate is we would now be $50,000 worse off at the end of the year than we were, so the thought is that the interurbans bring in more than the actual cost of maintaining the service, and it would be a mistake to abandon them. However, if large expenditures are necessary on the interurbans, I think the thought then will be to abandon them. We have to secure the permission of the Public Utilities Commission before any abandonment can be made effective.

Mr. Alpern:

Q. And the Trustees have not yet come to a decision on the question of abandonment of this property, or any property?

A. No, that is a very difficult question to arrive at, because we do not know what the effect of abandonment will be, or just what the effect of the abandonment of any par-

ticular property would be. Even the question of the incline is pretty hard to determine.

Q. Many of these leases between the Railways Company and the underliers have forfeiture clauses have they not?

A. Do you mean cancellation clauses?

Q. Yes, sir.

A. There are some terminations in them, but generally the operating agreements have cancellation clauses in them.

Q. And the franchises granted to the Pittsburgh Railways Company or to the underliers have provision for continuous operation of the underliers or their assignors, do you know that?

[fol. 59] A. That has generally been the term of the franchises I have been acquainted with in the past.—I don't know.

Q. If there is a breakup and the right of forfeiture was exercised by the assignors, could any of these underliers afford to operate their system independently?

A. I think that it would be a very difficult if not impossible proposition for any of the underliers to operate the property over which their securities extend.

Mr. Kountz:

Q. Mr. Fitzgerald, is it not a fact that most of those franchises of the underliers contain provisions permitting the forfeiture of the franchises if the line is not in operation?

A. I don't know whether it has permission to forfeit, or whether it is mandatory, but as a matter of fact, the forfeiture of a franchise through non-use would not affect the operation particularly, in my opinion, because if the rest of the property covered by the franchise is used by and useful to the public, service there would hardly be interrupted. Franchises have a theoretical value but it is largely theoretical.

W. D. George, a witness called by Counsel for the Trustees, being duly sworn, testified as follows:

Direct examination.

By Mr. O'Neill:

Q. Mr. George, you are one of the Trustees of the Pittsburgh Railways Company?

A. I am.

Q. And I believe you and a co-trustee, Mr. Benner, are the Trustees who are directed by the Court to prepare and [fol. 60] file a Plan of Reorganization for Pittsburgh Railways Company?

A. That is correct.

Q. Mr. George, will you state whether the Trustees are now using and operating the properties of the various underlying companies whose taxes have been discussed here this morning?

A. That is correct.

Q. As one of the two Trustees charged with the duty of preparing a plan, would you be in a position to make a statement with respect to what possible use may be contemplated for the property of these underliers under the Plan of Reorganization you have in mind?

A. In a general way, I believe that the properties will be operated as they are now laid out. That is, I do not believe there will be a great amount of abandonment of any part in the reorganization. I think most of the properties which are now in use will continue in use.

Q. A provision for the use of those properties would, in all likelihood, although you cannot say definitely, be made in the Plan of Reorganization?

A. I believe that is true.

Mr. Kountz: I would like the record to show, instead of the motion to strike it out, that our position is that the answer is of little value here, because it assumes a number of things. It assumes that the underliers' properties will be taken over and the taxes paid, whereas, as I pointed out before, the final result might be a divesture of taxes, and we feel the answer is too general to be the basis of any finding here.

Mr. Seifert: I would say in the present situation Mr. [fol. 61] George has answered that sufficiently. What eventually they may do is something for the Court later. Up to the present time the Trustees have taken no steps to abandon any of these leases. I think Mr. Kountz' objection is without any merit and I so submit to Your Honor.

The Master: It is manifestly impossible at this stage of this proceeding to determine what properties will be retained and what properties will not be retained. The Trustees themselves cannot entirely control or determine the

answer to that question. The Trustees are here asking instructions with respect to paying taxes and it may be that the degree of probability that certain properties will continue to be operated by this Company, or a new company, would have some bearing upon the action that the Trustees could wisely take with regard to the taxes. If there were some properties whose retention was quite doubtful, the payment of taxes with respect to those properties might be less advisable than the payment of taxes on properties which were almost certain to be retained. Whether it is feasible at this time to determine any schedule of property to be retained I do not know.

Mr. Seifert:

Q. Mr. George, have you and your associate trustees reached any conclusion as yet as to which companies which are presently operated by you as Trustees under 77-B will be abandoned?

A. With regard to that, I would not care to go any further than the statement I have made.

Q. I believe the statement you have made, as I understand, is that you and your co-trustees regard substantially all the properties as they are presently operated as neces-
[fol. 62] sary for future operation of the reorganized company?

A. I would have to answer that as I did your other question.

The Master:

Q. In other words, the matter is too uncertain to give any opinion, is that it?

A. Too uncertain.

Mr. Seifeit:

Q. At any rate, Mr. Geofge, the properties whose taxes you have asked to have considered by the Master as to payment of taxes, are presently being operated by the Trustees under 77-B?

A. Yes, sir.

Mr. W. D. George, recalled:

The Master:

Q. Mr. George, do you consider it practicable at this time for the Trustees to say what properties of the underlier companies will and what will not be embraced in the contemplated Plan of Reorganization?

A. I do not.

Adjournment to July 6, 1939, at 10:30 A. M.

[fol. 63] Hearing on Above Matter Resumed July 6, 1939, at 10:30 A. M. on Trustees' Petition with Reference to Payment of Taxes Pursuant to Adjournment

Present:

For the Trustees: J. Henry O'Neill, Esq.
For the City of Pittsburgh: Richard B. Tucker, Jr., Esq.
For Tort Creditors' Committee: Bernard Goodman, Esq.
For the Philadelphia Company: William A. Seifert, Esq.
For Citizens Traction Company: Richard W. Ahlers, Esq.

C. F. Ligo, being duly sworn, testified as follows:

Direct examination.

By Mr. O'Neill:

Q. Mr. Ligo, you are employed by the trustees of the Pittsburgh Railways Company in the capac ty of Chief Analyst?

A. I am.

Q. Are you familiar with the budget and estimated income and expenses for the twelve months ending May 31, 1939 which the trustees filed in connection with their petition requesting leave to make renewals, replacements and improvements to the debtor's properties?

A. I am. It was prepared under my supervision.

Q. Mr. Ligo, did you at my request yesterday prepare

a breakdown of certain items which appear under the heading "Income Deductions" of that estate?
[fol. 64] A. I did.

(A paper marked as Exhibit Number 3.)

Q. Mr. Ligo, I show you a paper marked Trustees' Exhibit Number 3 and I ask you if that is the breakdown of the particular items I spoke to you about?

A. It is.

Q. Now, first as to the item headed "Rent" which appeared on the budget under "Income Deductions", $2,418,859, would you state the principal items which are comprised within the word "rent"?

A. The amounts shown here comparatively are the actual amounts accrued on the books for this item of rent breakdown as follows: Interest on funded debt of leased property $1,441,645, interest on unfunded debt of leased property $137,396.00.

Rentals $830,275.00 or a total of $2,409,316, which compared with the $2,418,859 included in the budget.

Q. In other words, the $2,409,316 is the amount that was actually accrued for the budget period?

A. That is correct.

Q. Now, what is comprised within the "Interest on Funded Debt of Leased Property"?

A. That represents the interest on outstanding bond issues of leased companies.

Q. Do you mean the underlying companies?

A. I do.

Q. How many of these companies are there?

A. 33 companies.

Q. Can you state the number of bond issues that would be issued by those bond issues?

A. 42 bond issues.

Q. Of those companies, can you state which ones own tracks?

A. 27 of these 33 companies own tracks directly.

[fol. 65] Q. Now, as to the subdivision here as follows "Interest on Unfunded Debt of Leased Property". Will you state what items are comprised in that?

A. That is made up of interest on the demand notes of the Consolidated Traction Company and the United Traction Company held by the Philadelphia Company and the Duquesne Light Company.

Q. And the interest on those notes was payable by Pittsburgh Railways Company?

A. It was, yes sir.

Q. Now, will you tell us as to the last subdivision under the caption "Rentals" on this Exhibit 3. Will you state what that item is comprised of?

A. It represents the amount of rent provided for in the various agreements payable to the underlying companies.

Q. Do you mean those would be flat, fixed sums?

A. Flat, fixed sums, variable according to any reduction in stock that might be made by the Pittsburgh Railways Company purchasing those stocks. In other words, that varies with any reduction in the outstanding stock—that is in general.

Q. Do I understand that the rent was calculated to be in an amount that would be sufficient to pay a certain rate of dividends on stock of underlying companies?

A. That is correct.

Q. Mr. Ligo, can you state how many underlying companies received such rentals as you have described?

A. Fifteen.

Q. And certain of those 15 are included in the 27 companies?

A. That is correct. 11 of these companies which received rent also are included in the item above "Interest on Funded Debt of Leased Property".

[fol. 66] The Master:

Q. As I understand it, many of these lessor companies—so-called—were not the direct lessors of the Pittsburgh Railways Company, but underlay the United Traction Company or Consolidated Traction Company, is that correct?

A. That is correct.

Mr. O'Neill:

Q. I direct your attention to the item under "Income Deductions" which reads "Taxes of Lessor Companies" in the amount of $184,874.00 and I ask you what that item consists of?

A. This item consists of Federal income tax and State corporation net income tax. The amounts carried on the books for the twelve months ending May 31, 1939 were as

follows: Federal Income Tax $119,810.00, State Corporation Net Income Tax $49,752.00, or a total of $169,562.00, which compares with the budget amount of $184,874.00.

Q. And the trustees have accrued the Federal income tax item by reason of the fact that they have accrued interest and rentals that would be payable to the underlying companies?

A. That is correct.

Q. And for the same reason, they have accrued the State Corporation net income tax?

A. That is correct.

Q. Now, will you look at the item on the page under "Income Deductions" which reads "Miscellaneous (including tax on bond interest) $85,677.00" and tell us of what that consists?

A. It consists of the following, these amounts being the actual amounts accrued on the taxes.

Q. You are reading from Exhibit 3?

A. That is correct. Corporate Loan Tax $44,750.00, Federal Tax on Bond Interest paid or refunded (income at source) on leased property $3,850.00, Federal Tax on [fol. 67] income at source $2,825.00, miscellaneous $107.00, and Interest during construction a credit of $4,990.00, or a total of $46,542.00, which compares with $85,677.00 on the budget.

Q. Will you explain the reason for the difference between the budget amount and the actual amount you have just stated?

A. For the period of June 1 to December 31, 1938, the full amount of corporate loan tax, that is on the same basis as prior to the trusteeship, was accrued. Beginning January 1 to May 31, 1939, only the corporate loan tax on car trust interest was accrued. I think the books will be adjusted in order to make the books sustain that. This is the only type of tax where they change over. I think probably $30,000 will be added to that accrual for corporation loan taxes.

The Master:

Q. Does this corporate loan tax $44,750 represent the tax in respect to corporate loans on which the interest was actually paid?

A. No. This does not represent any payments here; but there is one of interest that has been paid and that is inter-

est on car trust certificates. That represents about $550 a month. Now, your total corporate loan tax prior to trusteeship represents $6,000 a month or $72,000 annually and to make it consistent with the way the income taxes are being accrued, I have it accrued on the old basis, even though it has not been paid, inasmuch as they are accruing the full interest. I think the budget amount or $85,677 is closer to representing the picture than this $46,000—it's half and half—7/12ths of one and 5/12ths of another,—that just come up in this thing yesterday.

Mr. O'Neill:

Q. The figures which appear in the last column on Exhibit 3 do not represent payments but only accruals made for the same period as the budget covered?

[fol. 68] A. Yes, sir.

Mr. O'Neill: Exhibit 3 is offered in evidence.

Mr. Tucker:

Q. I would like to know on what basis the accrual was made on the Federal income tax?

A. That was made on the basis that if the interest were paid this would be the income tax—all our income tax.

Q. Does that include rentals?

A. Yes, sir.

Q. And the figures stipulated in the leases?

A. On the figure that is accrued on the books. It may not be at the same rate as was on the original agreement because that may possibly be changed.

Q. It does not represent any use and occupation basis?

A. No, sir. This is the same as accrued prior to the trusteeship.

Mr. O'Neill:

Q. In fact, it carries forward the old basis?

A. Yes, sir.

Mr. Seifert:

Q. Do I understand as to that item of State Corporation Net Income Tax $49,752, you make an accrual that the State corporation net income tax would apply to the companies whose properties are leased and no longer operated by the company which owns that property?

A. That is correct. That is the basis on which this is accrued, but I understand that a recent court decision eliminates this tax.

Q. But that recent court decision has not become effective?

A. I don't know.

Q. But there has been an adjudication by Judge Hargest in Dauphin County that the state corporate loan tax is [fol. 69] a tax on the privilege of doing business and as such it would not be applicable to this case.

A. That is my understanding.

Q. No appeal has been taken to the Supreme Court from the Dauphin County case?

A. Not as far as I know.

Mr. O'Neill:

Q. Mr. Ligo, would you be prepared to state whether the Pittsburgh Railways Company has accrued on its books charges against United Traction Company, Consolidated Traction Company and certain underlying companies with respect to extraordinary repair or additions that the lessor company would be required to pay for under operating agreements?

A. I am not prepared to give any amount. Further, I am not an accounting officer but I do have a certain familiarity with the accounts and have worked with the accounting officers and I know there are substantial charges on the Pittsburgh Railways Company's books for those services. It applies to the United Traction Company, the Consolidated Traction Company and possibly ten other underliers.

Hearing closed.

REPORTER'S CERTIFICATE

Commonwealth of Pennsylvania,
County of Allegheny, ss:

I hereby certify that the foregoing pages contain a full, true and complete transcript of my stenographic notes as taken upon the above entitled matter.

Reported by,

Florence V. Ralston.

[fol. 70] TRUSTEES' EXHIBIT No. 1, APRIL 14, 1939

Pittsburgh Railways Company System

Unpaid Federal Income and Excess Profits Taxes and State Corporate Net Income Taxes for the Calendar Year 1937, Payable in the Year 1938

	Federal Income and Excess Profits Taxes Payments Due June 15, September 15, and December 15, 1938	State Corporate Net Income Taxes, Payment Due May 15, 1938
Allegheny Traction Company	$ 2,512.41	$ 875.00
The Citizens Traction Co.	22,820.94	6,312.39
The Suburban Rapid Transit Street Railway Company	6,405.00	1,956.86
Pittsburgh and Birmingham Traction Company	18,852.05	5,260.57
The Duquesne Traction Company	1,251.40	480.55
Federal Street and Pleasant Valley Passenger Railway Company	3,451.20	1,137.50
Mt. Oliver Incline Railway Company	111.04	58.59
Pittsburgh Incline Plane Company	1,383.71	524.69
Monongahela Street Railway Company	40,624.39	11,033.44
Total	$97,412.14	$27,639.59

Note:—The foregoing amounts are exclusive of interest.

[fol. 71] TRUSTEES' EXHIBIT No. 2, APRIL 14, 1939

Pittsburgh Railways Company

Unpaid Federal Income Taxes at Source for the Years 1937 and 1938

Name of Company	1937 (Note A)	1938 (Note B)
The Citizens Traction Co.	$ 29.00	$ 5.50
The Suburban Rapid Transit Street Railway Company	96.60	55.20

Name of Company	1937 (Note A)	1938 (Note B)
Pittsburgh and Birmingham Traction Company	6.00	3.00
The Duquesne Traction Company	63.50	22.00
Federal Street and Pleasant Valley Passenger Railway Company	665.16	312.38
The South Side Passenger Railroad Company	3.50	2.50
Penn Street Railway Company	16.00	28.00
Pittsburgh Railways Company (Southern Traction Co.)	2,982.52	1,535.67 (Note C)
Allegheny and Bellevue Street Railway Company	3.00	1.50
Pittsburgh, Allegheny and Manchester Traction Company	43.00	17.00
Washington and Canonsburg Railway Company	320.50	151.50
Washington Electric Street Railway Company	53.00	26.50
Ardmore Street Railway Company	347.50	163.50
Fort Pitt Traction Company	552.00	18.50
Pittsburgh, Canonsburg and Washington Railway Company	368.50	129.00
Pittsburgh, Crafton and Mansfield Street Railway Company	34.00	11.00
The Pittsburgh Traction Company	7.00	3.50
Second Avenue Traction Company	127.00	60.00
The Second Avenue Traction Company	1,201.00	83.50
United Traction Company of Pittsburgh	2,091.25	988.25
West End Traction Company	597.50	465.00
West Liberty and Suburban Street Railway Company	225.00	117.00
Millvale, Etna & Sharpesburgh St. Railway Co.		.75
Pittsburgh & Charleroi Street Railway Company		3.00
Total	$9,832.53	$4,203.75

Note A.: Tax became due and payable on June 15, 1938.
Note B: Tax becomes due and payable on June 15, 1939.
Note C: Of this amount, $110.40 represents tax payable at source on interest paid by the Trustees on Pittsburgh Railways Company Car Trust Bonds.

[fol. 72] TRUSTEES' EXHIBIT No. 3, JULY 6, 1939

W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees

Pittsburgh Railways Company

Debtor under Section 77-B Bankruptcy Act

Income Deduction Items

Amounts of certain items of Income Deductions included in the budget for the period June 1, 1938 to May 31, 1939

compared with the accrual actually made as per preliminary report for the corresponding period.

	Budget	Actual (Preliminary)
Rents:		
Interest on funded debt of leased property		$1,441,645
Interest on unfunded debt of leased property		137,396
Rentals		830,275
Total Rents	$2,418,859	$2,409,316
Taxes of Lessor Companies:		
Federal Income Tax		$ 119,810
State Corporation Net Income Tax		49,752
Total Taxes of Lessor Companies	$ 184,874	$ 169,562
[fol. 73] Miscellaneous (Including tax on Bond Interest):		
Corporate Loan Tax		$ 44,750
Federal Tax on Bond Interest paid or refunded (Income at Source) on Leased Properties		3,850
Federal Tax on Income at Source		2,825
Miscellaneous		107
Interest during Construction		*4,990*
Total Miscellaneous	$ 85,677	$ 46,542

July 5, 1939

(* Italic denotes red figures.)

[fol. 74] IN UNITED STATES DISTRICT COURT

SPECIAL MASTER'S REPORT ON PETITION OF TRUSTEES FILED MARCH 10, 1939 FOR INSTRUCTIONS WITH RESPECT TO TAXES —Filed August 22, 1939

To the Honorable, the Judges of said Court:

I, Watson B. Adair, to whom as Special Master this matter was referred, respectfully report as follows:

The Hearings

1. Pursuant to the Order of Court of March 10, 1939 and notice given in accordance therewith, I conducted a hearing on March 28, 1939 on "Petition of Trustees of Pittsburgh Railways Company, debtor, and Pittsburgh Motor Coach Company, subsidiary, praying for instructions with respect to certain taxes of the debtor and the subsidiary" filed March 10, 1939. At said hearing, there appeared J. Henry O'Neill and J. Garfield Houston, Esqs., of Blaxter, O'Neill & Houston, attorneys for the trustees; William A. Seifert, William Booth and H. G. Wasson, Jr., Esqs., attorneys for the Philadelphia Company; L. M. Alpern, Esq., attorney for the Tort Creditors Committee; Lee C. Beatty, Esq., attorney for Citizens Traction Company and Suburban Rapid Transit Street Railway Company; and Hill Burgwin, Esq., for Allegheny Traction Company. After some discussion, the hearing was adjourned to April 14, 1939 when there appeared Messrs O'Neill, Seifert, Booth, Alpern, Beatty and Burgwin, and also A. E. Kountz, Esq., for the Tort Creditors Committee and John D. Ray, Esq., and John E. Shea, [fol. 75] Esq., for the United States Bureau of Internal Revenue, Richard B. Tucker, Jr., Esq., for the City of Pittsburgh, and Mr. Thomas Fitzgerald, one of the trustees. Testimony was taken and the hearing was adjourned to May 15, 1939 when there appeared Messrs. O'Neill, Alpern, Beatty and Kountz. The hearing was then adjourned to May 25, 1939 when there appeared Messrs. O'Neill, Seifert, Booth, Alpern, Kountz and Tucker, and also Richard W. Ahlers, Esq., for Citizens Traction Company, Marland Gale, Esq., for Securities and Exchange Commission, Walter M. Newman, Esq., for Committee for Municipalities' Interest, and Messrs. W. D. George and Thomas Fitzgerald, trustees. The hearing was adjourned to June 9, 1939 when there appeared Messrs. O'Neill, Seifert, Alpern, Kountz, Tucker, Ahlers, Gale and Newman. Messrs W. D. George, Thomas M. Benner and Thomas Fitzgerald, the trustees, were present in person and testimony was taken. The hearing was adjourned to July 6, 1939 when there appeared Messrs. O'Neill, Seifert, Tucker and Ahlers, and Bernard Goodman, Esq. appeared for the Tort Creditors Committee. Further testimony was taken. The transcript of the stenographic notes of the testimony and proceeding is herewith transmitted together with exhibits numbers 1, 2 and 3.

The Objections

2. Written objections were presented by the Tort Creditors Committee to the payment by the trustees of the several taxes due from the underlying companies, which written objections are herewith transmitted. The City of Pittsburgh orally made like objection. The Philadelphia Company took the general position that the taxes of the underliers, as well as the taxes of the debtor and subsidiary should be paid and that unless the taxes of the underliers [fol. 76] were paid, none of the taxes should be paid. The Citizens Traction Company, Suburban Rapid Transit Street Railway Company and Allegheny Traction Company took the same position as the Philadelphia Company. However, the Philadelphia Company opposed the payment of claims against the underlying companies by the Commonwealth of Pennsylvania for corporate income tax on the ground that liability of the underlying companies for such taxes is disputable, and neither the Philadelphia Company nor anyone else appears to object to the payment of the so called Social Security taxes.

The Taxes Involved

3. At the hearing it appeared that in addition to the taxes named in the petition there are other unpaid taxes respecting which instructions are desired. All the taxes respecting which instructions are prayed or desired are the following (the index letters refer to the prayer of the petition):

Taxes Against the Debtor or Its Trustees

United States Taxes

1. Income tax for 1937 withheld at source by debtor
2. Income tax for 1938 withheld at source by debtor
3. Income tax for 1938 withheld at source by trustees
4. Social Security tax, Title VIII (old age benefit) on employes collected by employer for 1939
5.(e) Social Security Tax, Title VIII (old age benefit) for 1939
6.(e) Social Security Tax, Title IX (unemployment compensation) for 1939

[fol. 77] 7.(j) Income tax for 1937

8.(d) Income tax for 1938

Pennsylvania Taxes

9.(a) Capital Stock Tax for 1938
10.(c) Corporate Net Income Tax for 1938
11.(b) Corporate Loans Tax for 1938 respecting interest paid by debtor
12. Corporate Loans Tax for 1938 respecting interest paid by trustees
13.(e) Social Security Tax (unemployment compensation) for 1939

Taxes Against Pittsburgh Motor Coach Company or its Trustees

United States Taxes

14.(n) Social Security Tax, Title VIII (old age benefit) for first quarter of 1938
15. Social Security Tax, Title VIII (old age benefit on employees collected by employers for 1939
16.(m) Social Security Tax, Title VIII (old age benefit) for 1939
17.(m) Social Security Tax, Title IX (unemployment compensation) for 1939

Pennsylvania Taxes

18.(l) Capital Stock Tax, 1938
19.(m) Social Security Tax (unemployment compensation) for 1939

[fol. 78] Taxes Against Underlying Companies

United States Taxes

20. Income Tax for 1937 withheld at source
21. Income Tax for 1938 withheld at source
22.(k) Income Tax for 1937
23.(i) Income Tax for 1938

Pennsylvania Taxes

24.(f) Capital Stock Tax for 1938
25.(h) Corporate Net Income Tax for 1938
26.(g) Corporate Loans Tax for 1938

The Facts

4. The principal facts are set forth in the petition and need not here be restated. Additional facts were shown at the hearing.

5. (Items 1, 2, 3, 20, 21). The debtor paid interest in 1937 and 1938 on its own obligations and on obligations of underlying companies containing covenants whereby the obligor agreed to pay the income tax of the obligee up to 2% of such interest, and the Trustees paid interest after May 10, 1938, on obligations of the debtor (car trust bonds) containing such covenants. All said interest was paid without any actual deduction in respect to federal income tax. The unpaid amounts required by the Revenue Act to be "withheld" at the source respecting interest which was paid in 1937, and 1938, are as follows:

[fol. 79] Name of Company	Tax on interest paid in 1937	in 1938
The Citizens Traction Co.	$ 29.00	$ 5.50
The Suburban Rapid Transit Street Railway Company	96.60	55.20
Pittsburgh and Birmingham Traction Company	6.00	3.00
The Duquesne Traction Company	63.50	22.00
Federal Street and Pleasant Valley Passenger Railway Company	665.16	312.38
The South Side Passenger Railroad Company	3.50	2.50
Penn Street Railway Company	16.00	28.00
Allegheny and Bellevue Street Railway Company	3.00	1.50
Pittsburgh Allegheny and Manchester Traction Company	43.00	17.00
Washington and Canonsburg Railway Company	320.50	151.50
Washington Electric Street Railway Company	53.00	26.50
Ardmore Street Railway Company	347.50	163.50
Fort Pitt Traction Company	552.00	18.50
Pittsburgh, Canonsburg and Washington Railway Company	368.50	129.00
Pittsburgh, Crafton and Mansfield Street Railway Company	34.00	11.00
[fol. 80]		
The Pittsburgh Traction Company	$ 7.00	$ 3.50
Second Avenue Traction Company	127.00	60.00
The Second Avenue Traction Company	1,201.00	83.50

Name of Company	Tax on interest paid in 1937	in 1938
United Traction Company of Pittsburgh	$2,091.25	$988.25
West End Traction Company	597.50	465.00
West Liberty and Suburban Street Railway Company	225.00	117.00
Millvale, Etna & Sharpsburg St. Railway Co.	—	.75
Pittsburgh & Charleroi Street Railway Company	—	3.00
(Total on underliers' obligations	$6,850.01	$2,668.08)
Pittsburgh Railways Company	2,982.52	1,425.27
Pittsburgh Railways Company interest paid by Trustees after May 10, 1938		110.40
	$9,832.53	$4,203.75

The Tax respecting interest paid in 1937 was due and payable on June 15, 1938. The tax respecting interest paid in 1938 was due and payable on June 15, 1939.

6. (Items 1, 2, 3, 20, 21). From and after the dates the several interest payments referred to in paragraph 5 were made, the debtor, the debtor in possession, and the trustees, successively, always had on deposit in Farmers Deposit National Bank, in the account from which interest was paid, a balance larger than the amounts owing for the taxes listed in paragraph 5, plus all unpaid taxes which debtor retained [fol. 81] or collected from interest on wages as required by state or federal law.

7. (Items 7, 8, 10, 22, 23, 25). It does not appear that debtor owes any federal or state income tax for 1937, but the underlying companies owe federal income and excess profits taxes and may owe state corporate net income taxes for 1937 as follows (such taxes for 1938 are shown in Exhibit A attached to the petition):

	Federal Income and Excess Profits Taxes Payments Due June 15, September 15, and December 15, 1938	State Corporate Net Income Taxes, Payment Due May 15, 1938
Allegheny Traction Company	$ 2,512.41	$ 875.00
The Citizens Traction Co.	22,820.94	6,312.39
The Suburban Rapid Transit Street Railway Company	6,405.00	1,956.86
Pittsburgh and Birmingham Traction Company	18,852.05	5,260.57
The Duquesne Traction Company	1,251.40	480.55
Federal Street and Pleasant Valley Passenger Railway Company	3,451.20	1,137.50
Mt. Olivet Incline Railway Company	111.04	58.59
Pittsburgh Incline Plane Company	1,383.71	524.69
Monongahela Street Railway Company	40,624.39	11,033.44
	$97,412.14	$27,639.59

The state corporate net income tax for 1937 was payable [fol. 82] in semi-annual installments, April 15 and September 15, 1938. The April 15, 1938, installment was paid.

8. (Items 4, 5, 15, 16). In paying wages, the trustees are required to deduct 1% for Social Security tax owing by employes under Title VIII of the federal Social Security Act. The Act imposes a tax of the same percentage upon the employer. The taxable wages are approximately $500,000 per month.

9. (Items 6, 17). The wages taxable under Title IX of the Social Security Act (unemployment compensation) are about $500,000 per month.

10. (Items 11, 12, 26). The Pennsylvania Corporate Loans Tax for the year 1938, that is, in respect to interest payments made in 1938 prior to May 10, amounts to $10,442.79 in respect to interest paid on obligations of Pittsburgh Railways Company and $17,502.56 in respect to interest paid by that company on obligations of underlying companies. Of the total tax, $27,945.35, the sum of $302

was actually deducted from the interest paid to bondholders and the remaining was not so deducted. Reports respecting interest on obligations of underlying companies were made by them and the settlements of the amounts owing for the tax were made against them by the state officers. The procedure followed in respect to interest paid by the Pittsburgh Railways Company was as follows: A check was drawn on the debtor's bank account in the Farmers Deposit National Bank to the order of a paying agent for the full amount of the interest payable. Where the paying agent deducted the tax from the amount paid to the bondholder, it, the paying agent, returned to the debtor at the end of each month the amounts so deducted and the debtor deposited such sums in its general account in the [fol. 83] Farmers Deposit National Bank. The balance in that bank from January 1, 1938 to the date when the trustees took possession was always in excess of the amounts so deducted, plus amounts deducted from wages for the Social Security Tax, the lowest balance on deposit being $51,000. The trustees after May 10, 1938, paid interest on debtor's car trust certificates on which they (if the requirements of the state law are binding on them) were required to deduct $772 and did deduct $182, as appears by paragraph 12 of the petition.

11. The Pittsburgh Railways system has been operating as a unified system since 1902. It consists of street railways and inclines belonging to numerous underlying companies and includes buses operated by subsidiary, Pittsburgh Motor Coach Company.

12. The trustees have neither affirmed nor disaffirmed any of the leases or operating agreements under which the Pittsburgh Railways Company has possession of the properties of the several underlying companies.

13. Mr. W. D. George, one of the trustees charged with the duty of preparing a plan, believes that there will not be a great amount of abandonment of properties of underlying companies in the reorganization. He does not consider it practicable at this time for the trustees to say what properties of the underlying companies will and what will not be embraced in the contemplated plan of reorganization.

14. Mr. Fitzgerald, one of the trustees who has been in active charge of the operation of the Pittsburgh Railways

system since 1924, states that since it was created in 1902, there has been absolutely no effort to account for revenues and operating expenses of individual underlying companies, that the most rational approach to a method of doing so [fol. 84] would require an origin and destination statement for each ride taken, and an attempt to do this would be tremendously expensive and would entail so many assumptions as to the allocation of proportions of fares that it could not be used as a dependable basis for allocating revenues to individual companies, that to attempt to apply estimates of operating expenses against any method of estimating earnings would only accumulate additional assumptions and produce a net earnings estimate which would contain a multiplication of errors and therefore have no meaning, that the only way in which the net earnings of each underlier could be determined would be to operate each individually and that this would be of no value in the present problem, would be physically impossible and would not be satisfactory to the public or to the municipal and state authorities.

15. Mr. Fitzgerald further testified that he at present knows of no method of determining what relative rentals should be paid to the various underlying companies whose properties have been utilized by the debtor company or its trustees since May 10, 1938.

16. If the leases and operating agreements were currently effective, the amounts accrued for rental during the period June 1, 1938 to May 31, 1939 would consist of the following items:

Interest on funded debt of leased property—representing the interest on 42 outstanding bond issues of 33 leased companies, of which 27 owned tracks directly	$1,441,645
Interest on unfunded debt of leased property—being interest on the demand notes of the Consolidated Traction Company and the United Traction Company held by the Philadelphia Company and the Duquesne Light Company	137,396
[fol. 85] Rentals—being amounts sufficient to pay a certain rate of dividends on stock of 15 underlying companies, 11 of which are included in the 27 companies above mentioned	830,275
Total	$2,409,316

If the interest and rentals above mentioned were paid, there would be additional amounts payable for taxes.

17. The Pittsburgh Railways Company has on its books substantial charges against the United Traction Company of Pittsburgh, the Consolidated Traction Company and possibly ten other underlying companies in respect to extraordinary repairs or additions for which the lessor companies may be required to pay under operating agreements or leases, the amounts and merits of which charges have not been shown.

Discussion

18. Taxes accruing during the administration of an estate are payable as expenses of administration: People of the State of Michigan v. Michigan Trust Company, 286 U. S. 334, 52 S. Ct. 512 (franchise tax); Bright v. State of Arkansas (C. C. A. 8th) 249 F. 950 (franchise tax); Bear River Paper & Bag Company v. City of Petoskey (C. C. A. 6th) 241 F. 53 (personal property tax); Hammond v. Carthage Sulphite Pulp & Paper Company (C. C. A. 2d) 8 F. (2d) 35 (taxes on property); Macgregor v. Johnson-Bowdin-Emmerich (C. C. A. 2d) 39 F. (2d) 574 (real estate taxes); Central Vermont Railway Company v. Marsch (C. C. A. 1st) 59 F. (2d) 59 (real estate taxes); Coy v. Title Guarantee & Trust Company (D. C. Ore.) 212 F. 520 (personal property tax); McFarland v. Hurley (C. C. A. 5th) 286 F. 365 (tax on production of oil). The liability of the [fol. 86] estate for taxes appears also from the Act of Congress which reads as follows:

"State taxation; business conducted by receivers, trustees or other court officers subject to

"Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: * * *"

U. S. C. A. Title 28, Section 124 a. It follows that the taxes accruing against the debtor, Pittsburgh Railways Company, or the subsidiary, Pittsburgh Motor Coach Company, since May 10, 1938 are expenses of administration.

19. The next question is whether the taxes which constitute administration expenses in the present case should be paid as they become due. When this proceeding began, May 10, 1938, the debtor had $230,260 cash on hand. That amount increased so that the trustees had cash on hand March 1939 $1,537,247.46. It is inferred that substantially all of that increase was obtained by the operation of debtor's cars on the tracks of numerous underlying companies. Those companies may assert claims against the estate for this use of their property by the trustees. It has not been shown what are the fair rental values of the several properties or how their actual or relative contributions to the aggregate revenues of the trustees can be ascertained. It is now uncertain whether, on final accounting, there will be enough money or assets wherewith to pay those claims, if and as established, in addition to all the other costs and expenses of administration. There thus [fol. 87] being a possibility that the trusteeship may be or may become insolvent, it is necessary to consider whether payments by the trustees might result in improperly preferring one class of administration creditors, e. g., tax collectors or some trackage owners, to another, e. g., other trackage owners.

20. There is authority for the doctrine that taxes are entitled to priority over other administration expenses: Atkinson & Co. v. Alrich-Clisbee Co. (D. C. Mass. Morton J.) 248 Fed. 134; Piedmont Corp. v. Gainesville & N. W. R. Co. (Dis. Ct. Ga. Sibley J.) 30 F. (2d) 525; Coy v. Title Guarantee & Trust Company (C. C. A. 9th) 220 F. 90; Union Trust Co. v. Illinois M. R. Co. 117 U. S. 434, 481, 29 L. Ed. 963, 979. Whether or not that be so generally, in the present case it appears equitable that they be given priority over the possible claims of trackage owners for the use of the properties.

21. It is the duty of a common carrier to furnish and operate "a reasonably sufficient number of safe facilities, and run and operate the same with such motive power as may reasonably be required, in the transportation of all such passengers or property as may seek, or be offered to it, for such transportation * * *": Pennsylvania Act of May 28, 1937 P. L. 1053, Section 403, Purd. Pa. Digest, Title 66 Section 1173. This duty of the underlying com-

panies which own the tracks and franchises has been performed by Pittsburgh Railways Company or its receivers or trustees since 1902. The underlying owner companies are not presently prepared to resume the performance of their duty to the public. Even if they had the necessary capital, cars and personnel, their several properties have for a generation been operated as a unit and by force of circumstances the operation of many of them has become dependent upon the operation of others of them. It can [fol. 88] hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated. That operation appears to be as much for the benefit of the owner companies and their creditors as for the benefit of Pittsburgh Railways Company and its creditors. To the extent that the operation proves profitable, the underliers can be paid something for the use of their properties, probably more than they would have earned separately. Should the profits prove inadequate and the administration be insolvent, there will be nothing for the stockholders and creditors of Pittsburgh Railways Company, except in so far as those creditors have a lien on a minor part of the mileage, but the operation of the system will have preserved or tended to preserve the properties of the owner companies. The operation and management of the properties being for the common benefit, the current expenses thereof should be paid currently even though there ultimately may not be enough to pay the potential separate claims of the owner companies for compensation for the use of their properties.

22. There are many cases in which it has been held that where taxes accrue upon estates in the hands of receivers and are payable as administration expenses, the penalties and interest accruing by reason of delay in payment are likewise payable: Bright v. State of Arkansas (C. C. A. 8th) 249 Fed. 950; Foy v. Title Guarantee Company, 212 Fed. 520 (penalties only); McFarland v. Hurley, 286 Fed. 365 (interest and attorneys' fees); Ingels v.

Boteler (C.C. A. 9th) 100 F. (2d) 915. This last case arose [fol. 89] in a bankruptcy in which the Court held that Section 57 j of the Bankruptcy Act did not apply to state tax penalties accruing during administration. The Supreme Court granted a certiorari on April 24, 1939, and a more authoritative ruling may therefore be expected. In the absence of a new ruling to the contrary, it is concluded that penalties and interest have the same status as the taxes upon which they are based. It is therefore desirable that the taxes which are to be paid should be paid promptly.'

23. There are further reasons for paying some of the current taxes of the estate:

(a) The trustees have deducted the 1% social security tax from the wages of employes and could not in good conscience, withhold payment thereof to the tax collector.

(b) Unless the contributions owing to the state for social security tax, 2-7/10% of taxable wages, be paid on or before January 31, credit for the amount thereof could not be had as against the federal 3% tax unless it should be held that denial of the provisions of section 902 of the Social Security Act is a penalty and unless the imposition of penalties for delays in payment of taxes be held to be unlawful in the case of trustees. The penalty in the present case would be severe, possibly $160,000 per year.

(c) The trustees have deducted Pennsylvania Corporate Loans Tax from some payments of interest, and it would be unconscionable for them to withhold the same from the state.

Taxes on Underliers

24. It is uncertain that any of the leases or operating agreements will ever be accepted by the trustees. Unless [fol. 90] they be accepted, their covenants for payment of taxes will not bind the estate to pay the taxes of the underlying companies as administration expenses. There is no showing that the amounts, if any, owing to the respective companies for the net earnings of their properties or for the use of their properties by the trustees are proportionate to their taxes or even that in every case they are as much as their taxes. Payments of taxes regarded as payments for such earnings or use might give some companies a greater proportion of their dues than others and might even over-

pay some. If the debtor's claims (paragraph 17) against some of the underlying companies be meritorious, they may affect the equities. There does not appear to be any exigency which might justify the risk of effecting preferences or overpayments. It does not seem practicable to deal with the underliers' taxes in the mass, or to dispose of them separately upon the facts shown. At present the taxes of the underliers should not be paid by the trustees.

Particular Taxes

25. The Federal Income Tax for 1938 withheld at the source in respect to interest paid by the trustees on debtor's car trust bonds is governed by Section 143 of the Revenue Acts of 1936 and 1938, that section being the same in each Act. That section does not contemplate the actual deduction of any amount from the interest paid to the creditor but determines the liability of the corporation which has agreed to assume the payee's liability for income tax on the interest received. It is not necessary now to determine whether the corporation's liability is a tax upon it or whether it imposes upon it a liability analogous to that of a tax collector who has collected a tax and is answerable for it, or who has failed to collect a tax which he was bound [fol. 91] to collect. The liability appears to be extended by section 52 of the Revenue Act of 1938 to a corporation's trustee under the Bankruptcy Act and is an expense of administration.

26. The Federal Income Tax for 1937 and 1938 withheld at the source in respect to interest paid by the debtor in 1937 and 1938, under Section 143 of the Revenue Acts of 1936 and of 1938, did not become payable until after May 10, 1938, when this reorganization proceeding began. The question whether the time when the tax became payable, or the time when the interest was paid respecting which the tax accrues, is the test to determine whether the tax was a mere obligation antedating this proceeding or whether it is to be treated as an expense of administration, and the question whether the moneys in the bank to the credit of the debtor, when this proceeding began, included a trust fund which the government can follow and recover, should be determined, if and when presented in a claim by the government. On these questions, if raised, the Court should have the benefit of argument of counsel. It may be

that a present determination of these questions would not be binding in a later contest between the government and the trustees, if there should be such a contest.

27. There does not appear to be any unpaid federal or state Income Tax owing by the debtor for 1937 or 1938.

28. The Pennsylvania capital stock tax is a property tax: Dupuy v. Johns, 261 Pa. 40. That tax for 1938 against the debtor and against the subsidiary is an expense of administration.

29. The Pennsylvania Corporate Loans Tax is not a tax upon a corporation but upon the holder of the corporation's obligations: Commonwealth v. Lehigh V. R. Co., 186 Pa. 235. Under the Pennsylvania law, the treasurer of the [fol. 92] Pittsburgh Railways Company, when paying interest on its obligations, was required to deduct from the interest, and thus collect for the state, the corporate loans tax on the obligation upon which the interest was paid; and the corporation is chargeable for its treasurer's omission to do so: Commonwealth v Delaware Div. Canal Co. 123 Pa. 594; Commonwealth v. Philadelphia R. C. & I. Company, 137 P. 481. To the extent that actual deductions were made by the debtor's paying agent and returned to the debtor and deposited in its account in the Farmers Deposit National Bank, the trustees appear to have in their hands a trust fund belonging to the Commonwealth of Pennsylvania. It amounts to about $302, including deductions made from interest paid on obligations of underlying companies, and should be paid.

30. If it be thought that there is a trust fund in the hands of the trustees representing the Corporate Loans Tax for 1938 which the debtor did not deduct but which it had assumed to pay in relief of the obligees, or if it be thought that because the Corporate Loans Tax on interest payments made by the debtor in 1938 was not due until 1939 the liability became an administration expense, the Commonwealth of Pennsylvania may present an appropriate petition upon which the questions can be determined with finality. Unless and until such questions are determined in favor of the Commonwealth, that part of the tax for 1938 should not be treated as a trust fund or as an administration expense.

31. Does the duty of a Pennsylvania corporation to act as tax collector for Pennsylvania devolve upon trustees under the Bankruptcy Act? An Act of Congress, U. S. C. A. Title 28 Section 124, Judicial Code section 65, reads as follows:

"Management of property by receivers. Whenever in [fol. 93] any cause pending in any court of the United States there shall be a receiver or manager in possession of any property, such receiver or manager shall manage and operate such property according to the requirements of the valid laws of the state in which such property shall be situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof. Any receiver or manager who shall wilfully violate any provision of this section shall be fined not more than $3,000, or imprisoned not more than one year, or both."

Under a statute relating to liability to suit (U. S. C. A. title 28 sec. 125) a trustee under Section 77B or 77 of the Bankruptcy Act has been held to be a "receiver or manager": McGreavy v. Straw (Sup. Ct. N. H.) 39 A. B. R. (N. S.) 268; Anderson v. Scandrett, (Dist. Ct. Minn.) 19 F. Supp. 681; but see In re Smith 121 Fed. 1014. Assuming that this statute applies to such trustees, the question arises whether the payment of interest on the debtor's car trust bonds is a part of the management and operation of the property within the meaning of the statute. It has been held that this section 124 applies to a regulation of the rate of fare of street railways: Westinghouse E. & M. Company v. Binghamton Car Company, 255 Fed. 378; to an ordinance regulating the speed of trains: Erb v. Marsch 177 U. S. 584, 44 L. Ed. 897; to laws imposing liability for injuries to employes in specified circumstances: Peirce v. Van Dusen, 78 Fed. 693, Hornsby v. Eddy (C. C. A. 8th) 56 Fed. 461; and to a state law requiring distributors of motor vehicle fuel to obtain licenses and to execute bonds for payment of taxes: Gillis v. State, 293 U. S. 62, 55 S. Ct. 4. It seems sufficiently clear that the case is within the provisions of Section 124 of Title 28, above quoted, to warrant the view that the estate is liable for the collection of the [fol. 94] Corporate Loans Tax and that it would not be advisable for the trustees to engage in litigation to contest the liability. This tax respecting interest paid by the trustees therefore should be treated as an expense of administration.

32. The Social Security Tax, Title VIII (old age benefit) for the first quarter of 1938 owing by Pittsburgh Motor Coach Company does not appear to be an expense of administration as it accrued and was due and payable prior to May 10, 1938.

Recommendations

I recommend that the trustees of the Pittsburgh Railways Company and of the Pittsburgh Motor Coach Company be instructed as follows:

1. To pay the following taxes owing or to become owing together with any penalties and interest which may have accrued thereon:

Federal Income Tax withheld at the source in respect to interest paid by the trustees

Federal Social Security Tax, Title VIII (old age benefit) for 1939 on employes of the trustees, deductible from wages

Federal Social Security Tax, Title VIII (old age benefit) for 1939 in respect to employes of the trustees

Federal Social Security Tax, Title IX (unemployment compensation) for 1939 in respect to employes of the trustees

Pennsylvania Capital Stock Tax upon Pittsburgh Railways Company and upon Pittsburgh Motor Coach Company for 1938 due in 1939

Pennsylvania Corporate Net Income Tax upon Pitts- [fol. 95] burgh Railways Company or Pittsburgh Motor Coach Company or the trustees, if any, for 1938, on income earned after May 10

Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by the trustees

Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by debtor, whether on its own obligations or upon the obligations of others, to the extent that the tax was actually deducted by the paying agent from the interest paid and was returned by such agent to the debtor and deposited in debtor's account in Farmers Deposit National Bank, about $302.

Pennsylvania Social Security Tax (unemployment compensation) for 1939 in respect to employes of the trustees.

2. To refrain from paying the following taxes unless and until otherwise ordered by the Court:

Federal Income Tax for 1937 withheld at the source in respect to interest paid by debtor

Federal Income Tax for 1938 withheld at the source in respect to interest paid by debtor

Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by debtor, except so much of said Tax as was deducted and retained from interest and returned by the paying agent to the debtor and deposited in its account in the Farmers Deposit National Bank.

Social Security Tax, Title VIII (old age benefit) owing by Pittsburgh Motor Coach Company for the first quarter of 1938

[fol. 96] All United States taxes and Pennsylvania taxes against underlying companies.

Respectfully submitted, Watson B. Adair, Special Master.

August 22, 1939.

[fol. 97] IN UNITED STATES DISTRICT COURT

EXCEPTIONS OF PHILADELPHIA COMPANY TO REPORT AND RECOMMENDATIONS OF SPECIAL MASTER—Filed September 11, 1939

To the Honorable, the Judges of said Court:

And, Now, September 11th, 1939, comes the Philadelphia Company, by its counsel, Philip A. Fleger and William A. Seifert, and excepts to the "Special Master's Report on Petition of Trustees of Pittsburgh Railways Company, Debtor, and Pittsburgh Motor Coach Company, Subsidiary, filed March 10, 1939, for Instructions with Respect to Taxes", in respect of the following, to wit:

(a) The conclusion of the Special Master as set forth in Paragraph 24 of his report, to wit:

"It is uncertain that any of the leases or operating agreements will ever be accepted by the trustees. Unless they be accepted, their covenants for payment of taxes will not bind the estate to pay the taxes of the underlying companies as administration expenses. There is no showing that the amounts, if any, owing to the respective companies for the net earnings of their properties or for the use of their

properties by the trustees are proportionate to their taxes or even that in every case they are as much as their taxes. Payments of taxes regarded as payments for such earnings or use might give some companies a greater proportion of their dues than others and might even overpay some. If [fol. 98] the debtor's claims (paragraph 17) against some of the underlying companies be meritorious, they may affect the equities. There does not appear to be any exigency which might justify the risk of effecting preferences or overpayments. It does not seem practicable to deal with the underliers' taxes in the mass, or to dispose of them separately upon the facts shown. At present the taxes of the underliers should not be paid by the trustees."

(b) The conclusion of the Special Master as set forth in paragraph 25 of his report, to wit:

"The Federal Income Tax for 1938 withheld at the source in respect to interest paid by the trustees on debtor's car trust bonds is governed by Section 143 of the Revenue Acts of 1936 and 1938, that section being the same in each Act. That section does not contemplate the actual deduction of any amount from the interest paid to the creditor but determines the liability of the corporation which has agreed to assume the payee's liability for income tax on the interest received. It is not necessary now to determine whether the corporation's liability is a tax upon it or whether it imposes upon it a liability analogous to that of a tax collector who has collected a tax and is answerable for it, or who has failed to collect a tax which he was bound to collect. The liability appears to be extended by section 52 of the Revenue Act of 1938 to a corporation's trustee under the Bankruptcy Act and is an expense of administration."

(c) The conclusion of the Special Master as set forth in Paragraph 26 of his report, to wit:

"The Federal Income Tax for 1937 and 1938 withheld [fol. 99] at the source in respect to interest paid by the debtor in 1937 and 1938, under Section 143 of the Revenue Acts of 1936 and of 1938, did not become payable until after May 10, 1938, when this reorganization proceeding began. The question whether the time when the tax became payable, or the time when the interest was paid respecting which the tax accrues, is the test to determine whether the tax was a mere obligation antedating this proceeding or

whether it is to be treated as an expense of administration, and the question whether the moneys in the bank to the credit of the debtor, when this proceeding began, included a trust fund which the government can follow and recover, should be determined, if and when presented in a claim by the government. On these questions, if raised, the Court should have the benefit of argument of counsel. It may be that a present determination of these questions would not be binding in a later contest between the government and the trustees, if there should be such a contest."

(d) The conclusion of the Special Master as set forth in Paragraph 30 of his report, to wit:

"If it be thought that there is a trust fund in the hands of the trustees representing the Corporate Loans Tax for 1938 which the debtor did not deduct but which it had assumed to pay in relief of the obligees, or if it be thought that because the Corporate Loans Tax on interest payments made by the debtor in 1938 was not due until 1939 the liability became an administration expense, the Commonwealth of Pennsylvania may present an appropriate petition upon which the questions can be determined with finality. Unless and until such questions are determined in favor [fol. 100] of the Commonwealth, that part of the tax for 1938 should not be treated as a trust fund or as an administration expense."

(e) The recommendation of the Special Master that the trustees of the Pittsburgh Railways Company and of the Pittsburgh Motor Coach Company be instructed:

"2. To refrain from paying the following taxes unless and until otherwise ordered by the Court:

Federal Income Tax for 1937 withheld at the source in respect to interest paid by debtor

Federal Income Tax for 1938 withheld at the source in respect to interest paid by debtor

Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by debtor, except so much of said Tax as was deducted and retained from interest and returned by the paying agent to the debtor and deposited in its account in the Farmers Deposit National Bank

Social Security Tax, Title VIII (old age benefit) owing by Pittsburgh Motor Coach Company for the first quarter of 1938

All United States taxes and Pennsylvania taxes against underlying companies."

As the owner of all of the capital stock of Pittsburgh Railways Company, which company owns all of the capital stock of the Pittsburgh Motor Coach Company, and as the principal creditor of said Pittsburgh Railways Company, the Philadelphia Company respectfully requests leave to file reasons and brief in support of the foregoing exceptions.

[fol. 101] WHEREFORE, your exceptant respectfully submits to your Honorable Court that the above recommendation of the Special Master be not adopted and that the Trustees of the Pittsburgh Railways Company and of the Pittsburgh Motor Coach Company be instructed to pay the following taxes, to wit:

Federal Income Tax for 1937 withheld at the source in respect to interest paid by debtor

Federal Income Tax for 1938 withheld at the source in respect to interest paid by debtor

Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by debtor, except so much of said Tax as was deducted and retained from interest and returned by the paying agent to the debtor and deposited in its account in the Farmers Deposit National Bank

Social Security Tax, Title VIII (old age benefit) owing by Pittsburgh Motor Coach Company for the first quarter of 1938

All United States taxes and Pennsylvania taxes against underlying companies.

Respectfully submitted, Philip A. Fleger, W. A. Seifert, Attorneys for Philadelphia Co.

NOTE.—Exceptions identical to those of the Philadelphia Company were filed on September 11, 1939, jointly by Allegheny, Bellevue and Perrysville Railway Company; The Allenport and Roscoe Electric Street Railway Company; [fol. 102] Ben Avon and Emsworth Street Railway Company; Bon-Air Street Railway Company; Cedar Avenue Street Railway Company; East McKeesport Street Railway Company; Glenwood and Dravosburg Electric Street Railway Company; The McKeesport and Reynoldton Passenger Railway Company; Mt. Washington Street Railway

Company; Mt. Washington Tunnel Company; Pittsburgh, Allegheny, and Manchester Passenger Railway Company; The Pittsburgh, Allegheny and Manchester Traction Company; Pittsburgh and Charleroi Street Railway Company; Pittsburgh and West End Railway Company; Pittsburgh, Canonsburg and Washington Railway Company; Pittsburgh, Crafton and Mansfield Street Railway Company; Pittsburgh, Neville Island and Coraopolis Railway Company; Pittsburgh Union Passenger Railway Company; Second Avenue Passenger Railway Company; Second Avenue Traction Company; The Second Avenue Traction Company; Superior Avenue and Shady Avenue Street Railway Company; United Traction Company of Pittsburgh; Washington and Canonsburg Railway Company; West End Traction Company; West Liberty and Suburban Street Railway Company; West Shore Electric Street Railway Company; Consolidated Traction Company; Ardmore Street Railway Company; Central Passenger Railway Company; The Central Traction Company; Fort Pitt Traction Company; The Pittsburgh Traction Company; The Duquesne Traction Company; The Duquesne Street Railway Company; Federal Street and Pleasant Valley Passenger Railway Company; The Morningside Electric Street Railway Company; Seventeenth Street Incline Plane Company, and are not printed here for the reason that to do so would cause unnecessary duplication and unduly encumber the record.

[fol. 103] IN UNITED STATES DISTRICT COURT

EXCEPTIONS OF CITIZENS TRACTION COMPANY TO REPORT OF SPECIAL MASTER—Filed September 12, 1939

And now, to wit, September 11, 1939, comes the Citizens Traction Company, by Lee C. Beatty and Richard W. Ahlers, Esquires, its Counsel, and excepts to the Report of the Special Master in the following respects:

First. To the item in paragraph 1 of the "Recommendations" which approves payment of "Pennsylvania Capital Stock Tax upon Pittsburgh Railways Company and upon Pittsburgh Motor Coach Company for 1938, due in 1939", unless the Court also directs payment of like taxes assessed for said period upon exceptant and its wholly owned subsidiary Penn Street Railway Company.

Second. To the item in paragraph 1 of the "Recommendations" which approves payment of "Pennsylvania Corporate Net Income Tax upon Pittsburgh Railways Company or Pittsburgh Motor Coach Company or the Trustees, if any, for 1938 on income earned after May 10" (1938), unless the Court also directs payment of like taxes assessed for said period upon exceptant and its wholly owned subsidiary Penn Street Railway Company.

Third. To the item in paragraph 2 of the "Recommendations" which disapproves payment of "All United States taxes and Pennsylvania taxes against underlying companies" in so far as said recommendation relates to United States taxes and Pennsylvania taxes assessed against [fol. 104] exceptant and its wholly owned subsidiary Penn Street Railway Company.

Citizens Traction Company, Exceptant, by Lee C. Beatty, Richard W. Ahlers, its Attorneys.

NOTE.—Exceptions identical to those of the Citizens Traction Company were filed on September 12, 1939, by The Suburban Rapid Transit Street Railway Company and are not printed here for the reason that to do so would cause unnecessary duplication and unduly encumber the record.

[fol. 105] IN UNITED STATES DISTRICT COURT

EXCEPTIONS AND OBJECTIONS OF THE ALLEGHENY TRACTION COMPANY TO THE REPORT OF SPECIAL MASTER—Filed September 11, 1939

And now, to wit, September 11th, 1939, comes the Allegheny Traction Company by Burgwin, Scully and Churchill, Esquires, its Counsel, and excepts to the report of the Special Master in so far as it relates to his recommendation with regard to the payment of taxes levied and assessed by the United States and the Commonwealth of Pennsylvania against the said Allegheny Traction Company, said recommendation being as follows:

"2. To refrain from paying the following taxes unless and until otherwise ordered by the Court:

* * * * * * *

All United States taxes and Pennsylvania taxes against underlying companies."

This exceptant respectfully prays your Honorable Court to refuse to accept the recommendations of the Special Master as hereinbefore set forth and to order and direct the Trustees to pay all United States and Pennsylvania taxes levied and assessed against the Allegheny Traction Company, one of the underlying companies of the debtor.

Hill Burgwin, Burgwin, Scully and Churchill, Counsel for Allegheny Traction Company, Exceptant.

[fol. 106] IN UNITED STATES DISTRICT COURT

JOINDER OF SAMUEL H. PUTNAM IN EXCEPTIONS OF PHILADELPHIA COMPANY ET AL. TO REPORT OF SPECIAL MASTER—Filed September 29, 1939

To the Honorable, the Judges of Said Court:

And now, September 29, 1939, comes Samuel H. Putnam, a general creditor and owner of securities of underlying companies, and joins in the exceptions to the "Special Master's Report on Petition of Trustees of Pittsburgh Railways Company, Debtor, and Pittsburgh Motor Coach Company, Subsidiary, filed March 10, 1939, for Instructions with Respect to Taxes", filed September 11, 1939 by the Philadelphia Company and underlying companies of the Pittsburgh Railways Company.

John M. Reed, Attorney for Samuel H. Putnam.

[fol. 107] IN UNITED STATES DISTRICT COURT

OPINION—Filed October 26, 1939

McVICAR, J.:

This case is before us on exceptions to the Special Master's report relative to payment of taxes. The Special Master recommended, inter alia, that all taxes assessed against the underliers be not paid at this time. The question argued, (which is the principal question involved) is whether the court should direct the payment of taxes against

the underliers (which are not in dispute) which became due and payable since the approval of the debtors' petition under Sec. 77B of the Bankruptcy Act.

The debtors' petition was filed May 10, 1938 and was approved on the same date. June 14, 1938, permanent trustees were appointed for the debtors, and in said order, the trustees were authorized to

"preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the Debtor, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues and profits of said property and estate; * * *"

and

"to pay all taxes and assessments due or to become due upon the property in possession of and/or owned by the Debtor; * * *".

[fol. 108] The Pittsburgh Railways Company, since 1902, has operated approximately 1160 miles of street railway, incline plane properties, and through its subsidiary, Pittsburgh Motor Coach Company, a line of buses. Twenty-eight miles of said street railway is owned by the Pittsburgh Railways Company; the remaining 1132 miles is operated by it by virtue of operating agreements and leases from 55 separate underlier companies. The underlying companies own car barns in which the debtors' cars are stored while not in use.

Since approval of debtors' petition, there has become payable to the Commonwealth of Pennsylvania, Social Security Taxes, Corporate Stock Taxes, Corporate Net Income Taxes and Corporate Loan Taxes; also, United States Income Taxes and Social Security Taxes.

March 13, 1939, the trustees of the Pitttsburgh Railways Company and Pittsburgh Motor Coach Company, a subsidiary, filed a petition requesting directions in regard to the payment of said taxes, which are more specifically enumerated therein. Objections to the payment of the taxes levied against the underliers were made by the committee representing the tort creditors, and by the City of Pittsburgh for the reasons appearing in paragraph 24 of the Special Master's report. The underlying companies, the

Philadelphia Company and at least one other creditor claimed that said taxes are administration expenses, and that the court should direct the payment thereof. I am of the opinion that the contention of the underlying companies, et al. (with the qualification set forth in the decree filed with this opinion) should be sustained. It will not be necessary to discuss the reasons appearing in the Special Master's report.

As stated before, the Pittsburgh Railways system has [fol. 109] been operated as a unit since the year 1902 and it is still so operated by the trustees. It seems to be generally agreed that any feasible plan of reorganization will have to be based on a unified system. The trustees have ample money from the income received in the operation of said system to pay said taxes. The income received from operation has been kept in one fund and treated as one fund since the system has been operated as a unit, and there is no means, now at least, of determining the income which was received from each of the underliers and from the debtors. The United States is arging payment of the taxes levied against the underlying companies and has intimated at the oral argument of the exceptions to the Special Master's report, in court, that it might distrain in order to collect said taxes. The taxes have always been paid from the income of the unified system, which includes local taxes to the City of Pittsburgh and the County of Allegheny. The local taxes have been paid since the approval of the debtors petitions. Administration expenses have been recognized as including wages, salaries, cost of supplies, repairs on properties of the underliers, insurance premiums, and for the purchase of leasing of cars used in the system. It is conceded that taxes levied against properties of the debtors should be paid as administration expenses from income received from the entire system, although there is no means of determining how much of that income, if any, should be allocated to the debtor companies.

Orders for payment similar to the order contended for by the underliers, have been made in the cases of American Brake Shoe Co. et al. v. ittsburgh Railways Company, No. 201, May Term, 1918, in Equity (W. D. Pa.); Philadelphia Rapid Transit Company, debtor, No. 18204 (E. D. of Pa.); Westinghouse Elect[illegible] & Manufacturing Co. v. Brooklyn Rapid Transit Co., 6 Fed. (2d) 547, (C. C. A. 2).

[fol. 110] The Act of Congress, June 18th, 1934 (28 U. S. C. A. 124 a) provides:

"Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation * * *"

In Michigan v. Michigan Trust Company, 286 U. S. 334, Justice Cardozo, speaking for the Supreme Court, said:

"* * * Taxes owing to the Government, whether due at the beginning of a receivership or subsequently accruing, are the price that business has to pay for protection and security. Coy v. Title Guarantee & T. Co. L. R. A. 1915E, 211, 135 C. C. A. 658, 220 Fed. 90, 92. The privilege fees, being taxes, were expenses of administration within the very terms of the order, but in addition they were taxes of such an order that the corporation by failing to pay them became subject, if the State so elected, to a forfeiture of its franchise. Act No. 172 Public Acts 1923 Sec. 7; cf. Turner v. Western Hydro-Electric Co., 241 Mich. 6, 216 N. W. 476. The receiver was under a duty to pay them when they accrued, and having failed to fulfill that duty then, it should be compelled to pay them now. The decisions as to this are persuasive and uniform. Coy v. Title Guarantee & T. Co. L. R. A. 1915E, 211, 135 C. C. A. 658, 220 Fed. 90, supra; Bright v. Arkansas, 162 C. C. A. 148, 249 Fed. 950; McFarland v. Hurley (C. C. A. 5th) 286 Fed. 365; New York v. Hopkins (C. C. A. 2d) 18 F. (2d) 731, 733; cf. Re Tyler, 149 [fol. 111] U. S. 164, 182, 37 L. Ed. 689, 695, 13 S. Ct. 785."

In Coy v. Title Guarantee & Trust Co., et al., 220 Fed. 90, (C. C. A. 9), it is stated:

"It is too clear for argument that the appointment of a receiver and the taking of property into the hands of the court through its officer does not withdraw it from taxation. It remains subject to assessment and to the payment of all legal taxes thereon while in custodia legis, to the same extent as it was while in the possession of the owner. And

whether or not such taxes be a lien or a debt by the laws of the government within whose jurisdiction the property is situated, such taxes are and should be regarded by the courts as a preferred and paramount claim over all other claims, for they are essential to the existence and maintenance of the very government under which the property is acquired and protected.

" 'A court', said Cooley on Taxation (3d Ed.) Vol. 2, p. 834, 'having in its charge or under its control a fund or other property upon which taxes are due, will, as the representative of the sovereignty, direct them to be paid without raising any question of the means of enforcement by process, and before all other claims except judicial costs. Thus upon proper application and suitable proof a receiver will be ordered to satisfy a tax assessed against the property in his hands, and a like direction will be made in other cases where funds are held subject to the authority of the court.' "

In Bear River Paper & Bag Co. et al. v. City of Petoskey et al., 241 Fed. 53 (C. C. A. 6), it is stated:

"We think it unnecessary to decide the question of lien. [fol. 112] These taxes were owing to the state, the county, and the city as the consideration for governmental benefits enjoyed by this property and this business during three years. The property has been in possession of the receivers, and the business has been conducted by them. It is not claimed that any other tax has been assessed in this state against them, or against the property, or against the mortgagor, or mortgagee, or mortgage bondholders. It might have been assessed against the receivers, for C. L. Sec. 3837 (6) says:

" 'Personal property mortgaged or pledged shall be deemed the property of the person in possession thereof, and may be assessed to him.'

"It is not claimed that the taxes are unjust or in any way inequitable. Under these conditions, and even if it were to be assumed that the taxes had not become a lien against the property, or that, through the mistake of the assessing officers, no enforceable debt against the receivers had arisen, a due regard for the rightful burdens of all citizens and residents toward the state government, and a due recognition of benefits received should impel a federal court to

direct its receiver to make payment. Such payment, in the absence of a meritorious objection to the tax, we regard as the receiver's clear duty; and so it has been held, in substance, if not specifically. In Re Tyler, 149 U. S. 164, 187, 13 Sup. Ct. 785, 37 L. Ed. 689; Coy v. Title Co. (C. C. A. 9) 220 Fed. 90, 92, 135 C. C. A. 658, L. R. A. 1915E, 211."

See Gerdes on Corporate Reorganizations, Sec. 1181; MacGregor v. Johnson-Cowdin-Emmerich, Inc., 39 Fed. (2d) 574 (C. C. A. 2); Pennsylvania Company for Insurance on Lives, etc. v. Philadelphia Company, etc., 266 Fed. 1 [fol. 113] (C. C. A. 3); Hardee et al. v. American Security & Trust Co., 77 Fed. (2d) 382 (C. C. A. Dist. Columbia).

The rule laid down in the above authorities should be applied to taxes levied against the underliers in this case. The system is a unit; it is proposed to reorganize it as a unit; the fund from which the taxes are to be paid arise from this unit; the taxes must be paid ultimately; interest and penalties are accruing by reason of non-payment; the taxes "are the price that business has to pay for protection and security"; "taxes are and should be regarded by the courts as a preferred and paramount claim over all other claims." The same rule should be applied to State and Federal taxes as applies to local taxes. Taxes legally levied against the underliers and which became due and payable after the approval of the original petition are an administration expense and should be ordered paid, subject to the qualification in the decree filed herewith.

IN THE UNITED STATES DISTRICT COURT

ORDER DIRECTING PAYMENT OF TAXES—Filed October 26, 1939

And now, to-wit, October 26th, 1939, this Court, by Order entered March 10, 1939, having referred to Watson B. Adair as Special Master, for a hearing and report thereon, the petition filed March 10, 1939 by W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary, praying for instructions with respect to the payment of certain taxes; and it appearing that notice of the hearing to be held before the Special Master

and of the hearing to be held by a Judge of this Court upon [fol. 114] the said petition and report of the Special Master and on any exceptions filed thereto was duly given, in accordance with the provisions of the aforesaid Order of Court, to Pittsburgh Railways Company, debtor, and Pittsburgh Motor Coach Company, subsidiary, their creditors, claimants, stockholders and indenture trustees, their subsidiaries and affiliated companies and indenture trustees, under their issues, the Securities and Exchange Commission, the Secretary of the Treasury and all other persons interested in the within reorganization proceeding whose names appear on the books and records of the debtor and its subsidiary; and the hearing before the Special Master having been held and the Special Master having filed his report on said petition, and said petition and report and the exceptions filed thereto having come on for a hearing by a Judge of this Court on October 3, 1939 and having been argued by counsel, and all persons who desired to be heard thereon having been heard; upon consideration thereof, it is ordered, adjudged and decreed as follows:

(a) That W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary, be and they are hereby instructed and directed to pay the following taxes, together with any penalties and interest which may have accrued thereon:

1. Federal Income Tax for the year 1937 withheld at the source in respect to interest paid by the debtor upon its own obligations and upon the obligations of the underlying companies in the debtor's transportation system.

2. Federal Income Tax for the year 1938 withheld at the source in respect to interest paid by the debtor upon its own obligations and upon the obligations of the under- [fol. 115] lying companies in the debtor's transportation system, and in respect to interest paid by the Trustees of the debtor.

3. Unpaid balances of Federal Income Taxes of the underlying companies in the debtor's transportation system for the year 1937.

4. Federal Income Taxes of the underlying companies in the debtor's transportation system for the year 1938

except to the extent it shall be determined that such taxes were produced by reason of payments made to underlying companies by the Philadelphia Company in discharge of its obligations as guarantor of the performance of lease covenants.

5. Federal Social Security Tax, Title VIII (old age benefit) for the year 1939 on employes of the Trustees of the debtor and of the subsidiary, deductible from wages.

6. Federal Social Security Tax, Title VIII (old age benefit) for the year 1939 in respect to employes of the Trustees of the debtor and of the subsidiary.

7. Federal Social Security Tax, Title IX (unemployment compensation) for the year 1939 in respect to employes of the Trustees of the debtor and of the subsidiary.

8. Pennsylvania Social Security Tax (unemployment compensation) for the year 1939 in respect to employes of the Trustees of the debtor and of the subsidiary.

9. Pennsylvania Capital Stock Tax of the debtor and of the subsidiary for the year 1938.

10. Pennsylvania Capital Stock Taxes of the underlying companies in the debtor's transportation system for the year 1938.

11. Pennsylvania Corporate Loans Tax for the year 1938 in respect to interest paid by the debtor upon its own [fol. 116] obligations and upon the obligations of the underlying companies in the debtor's transportation system, and in respect to interest paid by the Trustees of the debtor.

12. Pennsylvania Corporate Net Income Taxes of the underlying companies in the debtor's transportation system for the year 1937 (the installment due May 15, 1938), and for the year 1938, when and if it shall be determined in the controversy now pending with the Commonwealth of Pennsylvania that the said underlying companies are liable for the payment of such taxes under the provisions of the Pennsylvania Corporate Net Income Tax Law.

(b) That the exceptions filed to the report of Watson B. Adair, Special Master, upon the aforesaid petition of the Trustees be and they are hereby sustained in so far as they are in accordance with the foregoing provisions of this

Order and are dismissed in so far as they are not in accordance therewith.

By the Court, V.

[fol. 117] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL OF TORT CREDITORS' COMMITTEE TO THE CIRCUIT COURT OF APPEALS—Filed November 25, 1939

To—G. H. BERGER, Clerk:

Notice is hereby given that Walter L. Dipple, James P. McArdle, Ben Paul Brasley and Thomas J. Hoffman, a committee constituted to protect the interests of the persons having claims against the Pittsburgh Railways Company, debtor above named, and Pittsburgh Motor Coach Company, its subsidiary, for causes of action for damages based on negligence in the operation of the business of the debtor and subsidiary and designated as "Tort Creditors' Committee", intervenors in the above entitled proceeding, hereby appeal to the Circuit Court of Appeals for the Third Circuit from the order entered in this proceeding on October 26, 1939, insofar as the same directs the payment of the following taxes:

1. Federal Income Taxes for the year 1937 withheld at the source in respect to interest paid by the debtor upon the obligations of the underlying companies in the debtor's transportation system.

2. Federal Income Taxes for the year 1938 withheld at the source in respect to interest paid by the debtor upon the obligations of the underlying companies in the debtor's transportation system.

3. Unpaid balance of the Federal Income Taxes of the [fol. 118] underlying companies in the debtor's transportation system for the year 1937.

4. Federal Income Taxes of the underlying companies in the debtor's transportation system for the year 1938.

5. Pennsylvania Capital Stock Taxes of the underlying companies in the debtor's transportation system for the year 1938.

6. Pennsylvania Corporate Loan Taxes for the year 1938 in respect to interest paid by the debtor upon the obligations of the underlying companies in the debtor's transportation system.

7. Pennsylvania Corporate Net Income Taxes of the underlying companies in the debtor's transportation system for the year 1937 and the year 1938.

A. E. Kountz, Lewis M. Alpern, Attorneys for Appellants, Walter L. Dipple, James P. McArdle, Ben Paul Brasley and Thomas J. Hoffman, Tort Creditors' Committee.

[fol. 119] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL OF CITY OF PITTSBURGH TO THE CIRCUIT COURT OF APPEALS—Filed November 25, 1939

Notice is hereby given that the City of Pittsburgh hereby appeals to the United States Circuit Court of Appeals for the Third Circuit from those parts of the order entered on October 26, 1939, which direct the Trustees to pay the taxes of the underlying companies, more particularly the following parts of said order insofar as they relate to any taxes of the various underlying companies:

Sections (a) 1, (a) 2, (a) 3, (a) 4, (a) 10, (a) 11, and (a) 12.

Wm. Alvah Stewart, Solicitor for City of Pittsburgh.

November 25, 1939.

[fol. 120] IN UNITED STATES DISTRICT COURT

DESIGNATION OF CONTENTS OF RECORD ON APPEAL—Filed December 13, 1939

And now, to-wit, December 13, 1939, come the City of Pittsburgh and the Tort Creditors Committee, appellants, and designate the following portions of the record, proceedings and evidence as the Record on Appeal from the Order of Court of October 26, 1939, directing the payment of certain taxes:

1. Relevant Docket entries as approved by order of Court of December 11, 1939, and the Order of Court of December 11, 1939.

2. Trustees' petition for instructions with respect to certain taxes of the debtor and the subsidiary and the order of reference filed March 10, 1939.

3. Objections of the Tort Creditors Committee to the payment of certain tax items, filed April 14, 1939.

4. All of the evidence taken before the Special Master, filed August 22, 1939, omitting only the discussions of counsel found on the following pages of the transcript: pages 3 to 10 inclusive; pages 21 to 39 inclusive; pages 71 to 75 up to the testimony of W. D. George.

5. Trustees' Exhibits Nos. 1, 2 and 3.

6. Special Master's Report, filed August 22, 1939.

7. Exceptions of Philadelphia Company to Master's Report, filed September 11, 1939.

[fol. 121] 8. The following statement to be printed:

"Exceptions identical to those of the Philadelphia Company were filed on September 11, 1939, jointly by Allegheny, Bellevue and Perrysville Railway Company; The Allenport and Roscoe Electric Street Railway Company; Ben Avon and Emsworth Street Railway Company; Bon-Air Street Railway Company; Cedar Avenue Street Railway Company; East McKeesport Street Railway Company; Glenwood and Dravosburg Electric Street Railway Company; The McKeesport and Reynoldton Passenger Railway Company; Mt. Washington Street Railway Company; Mt. Washington Tunnel Company; Pittsburgh, Allegheny, and Manchester Passenger Railway Company; The Pittsburgh, Allegheny and Manchester Traction Company; Pittsburgh & Charleroi Street Railway Company; Pittsburgh and West End Railway Company; Pittsburgh, Canonsburg and Washington Railway Company; Pittsburgh, Crafton and Mansfield Street Railway Company; Pittsburgh, Neville Island and Coraopolis Railway Company; Pittsburgh Union Passenger Railway Company; Second Avenue Passenger Railway Company; Second Avenue Traction Company; The Second Avenue Traction Company; Superior Avenue and Shady Avenue Street Railway Company; United Traction Company of Pittsburgh; Washington and Canonsburg Rail-

way Company; West End Traction Company; West Liberty and Suburban Street Railway Company; West Shore Electric Street Railway Company; Consolidated Traction Company; Ardmore Street Railway Company; Central Passenger Railway Company; The Central Traction Company; [fol. 122] Fort Pitt Traction Company; The Pittsburgh Traction Company; The Duquesne Traction Company; The Duquesne Street Railway Company; Federal Street and Pleasant Valley Passenger Railway Company; The Morningside Electric Street Railway Company; Seventeenth Street Incline Plane Company, and are not printed here for the reason that to do so would cause unnecessary duplication and unduly encumber the record."

9. Exceptions of The Allegheny Traction Company to Master's Report, filed September 11, 1939.

10. Exceptions of Citizens Traction Company to Master's Report, filed September 12, 1939.

11. The following statement to be printed:

"Exceptions identical to those of the Citizens Traction Company were filed on September 12, 1939, by The Suburban Rapid Transit Street Railway Company and are not printed here for the reason that to do so would cause unnecessary duplication and unduly encumber the record."

12. Joinder in exceptions to Master's Report by Samuel H. Putnam, filed September 29, 1939.

13. Opinion of Judge McVicar, filed October 26, 1939.

14. Order of Court, filed October 26, 1939.

15. Notice of Appeal of Tort Creditors Committee, filed November 25, 1939.

16. Notice of Appeal of City of Pittsburgh, filed November 25, 1939.

[fol. 123] 17. Designation of Contents of Record, filed December 13, 1939.

18. Designation of Appellants points, filed December 13, 1939.

19. Certificate of Clerk.

Wm. Alvah Stewart, Attorney for the City of Pittsburgh, Appellant.

A. E. Kountz, Lewis M. Alpern, Attorneys for Tort Creditors Committee, Appellant.

[fol. 124] IN UNITED STATES DISTRICT COURT

STATEMENT OF APPELLANTS' POINTS ON APPEAL—Filed December 13, 1939

And now, to-wit, December 13, 1939, the City of Pittsburgh and the Tort Creditors Committee, appellants from the order of court of October 26, 1939, directing the Trustees of Pittsburgh Railways Company, debtor, to pay certain taxes, hereby designate the following points as the points on which they intend to rely on the appeal:

1. That the court erred in directing the payment of taxes accrued against the underlying companies which were due and owing prior to May 10, 1938, the date of the filing of the petition for reorganization, for the reason that said items were at no time and are not administration expenses during reorganization and are not tax obligations of the debtor entitled to priority in payment over the claims of unsecured creditors, but are mere contract obligations of the debtor on a parity with the other unsecured claims against the debtor.

2. That the court erred in holding that by virtue of the unified operation of the debtor's railway system the Trustees' obligation to pay the taxes accrued against the underlying companies during the period of administration and reorganization is a tax obligation of the debtor in possession and of the Trustees and, therefore, payable as taxes of the debtor company.

3. That inasmuch as the Trustees have not as yet either affirmed or rejected the executory contracts between the debtor corporation and the several underliers or any of [fol. 125] them whereby the debtor obligated itself to pay, inter alia, the taxes of the underliers in question, the court erred in failing to hold that unless and until the several leases and operating agreements are affirmed, the only claim of the underliers during the period of administration in reorganization is for use and occupancy.

4. That inasmuch as the measure of use and occupancy in public utility reorganization cases is the net earnings realized from the operation of the lessors' properties, the court erred in directing the Trustees to pay the taxes accrued against the debtor's underlying companies during

the administration in reorganization without requiring proof that the net earnings attributable to each of the underliers is equal to or in excess of the taxes of each of them.

5. That the payment of the underliers taxes incurred during the period of administration in reorganization without the establishing of the earnings of each underlier's property may cause preferences and over-payments.

6. That there are no special equities which would warrant the District Court in refusing to apply the general rules applicable to the payment of use and occupancy by Trustees in reorganization of public utility companies.

Wm. Alvah Stewart, Attorney for City of Pittsburgh.
A. E. Kountz, Lewis M. Alpern, Attorneys for Tort Creditors Committee.

[fol. 126] IN UNITED STATES DISTRICT COURT

ORDER OF COURT AND STIPULATION—Filed December 22, 1939

And now, to-wit, this 22nd day of December, 1939, upon motion of counsel and after due consideration, it is ordered that the time for the filing of the record on appeal with the Clerk of the Circuit Court of Appeals in the appeals of the City of Pittsburgh and the Tort Creditors Committee from an Order entered by this Court on October 26, 1939, be extended from January 4, 1940 to January 18, 1940, provided that both the typewritten and printed record be filed on or before January 18, 1940.

By the Court, V.

And now, to-wit, December 22, 1939, it is hereby stipulated by the City of Pittsburgh and the Tort Creditors Committee, through their respective counsel, that their printed brief or briefs will be filed on or before February 3, 1940.

Richard B. Tucker, Jr., Attorney for City of Pittsburgh.
Lewis M. Alpern, Attorney for Tort Creditors Committee.

[fol. 127] IN UNITED STATES DISTRICT COURT

ORDER OF COURT AND EXCEPTION—Filed December 22, 1939

And now, to-wit, December 22nd, 1939, upon consideration of the foregoing motion of Blaxter, O'Neill & Hous-

ton, counsel for W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and Pittsburgh Motor Coach Company, subsidiary, it is ordered that there be filed and docketed in the office of the Clerk of this Court and made a part of the record in this proceeding the "Recommendation of Counsel For Trustees Relative To Trustees Petition For Instructions With Respect To Certain Taxes" which Blaxter, O'Neill & Houston filed with McVicar, J. personally on or about October 20, 1939, pursuant to his direction so to do, and which document does not appear to have heretofore been filed and docketed in the office of the Clerk of this Court.

By the Court, V.

Eo die exception noted to City of Pittsburgh and Tort Creditors Committee.

McVicar, D. J.

[fol. 128] IN UNITED STATES DISTRICT COURT

DESIGNATION OF ADDITIONAL PORTIONS OF THE RECORD, PROCEEDINGS AND EVIDENCE TO BE INCLUDED IN THE RECORD ON APPEAL—Filed December 22, 1939

And now, to-wit, December 22, 1939, come W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and Pittsburgh Motor Coach Company, subsidiary, and designate as an additional portion of the record, proceedings and evidence to be included in the record on appeal, and also as an additional docket entry to be included in the list of docket entries to be printed, in the manner and form it may be docketed, the following:

"Recommendations of Counsel for Trustees Relative to Trustees' Petition for Instructions with Respect to Certain Taxes."

Blaxter, O'Neill & Houston, Counsel for W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, Debtor, and Pittsburgh Motor Coach Company, Subsidiary.

[fol. 129] IN UNITED STATES DISTRICT COURT

RECOMMENDATIONS OF COUNSEL FOR TRUSTEES RELATIVE TO TRUSTEES' PETITION FOR INSTRUCTIONS WITH RESPECT TO CERTAIN TAXES—Filed December 22, 1939

To the Honorable, the Judges of said Court:

Blaxter, O'Neill & Houston, counsel for W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary, submit herewith, pursuant to the request of your Honorable Court, their recommendations with respect to the Trustees' petition filed March 10, 1938 praying for instructions as to the payment of certain State and Federal taxes and the report of the Special Master thereon.

In his report the Special Master, in substance, recommended that certain of the taxes of the debtor or its Trustees concerning which instructions were asked, be paid in full by the Trustees and others only in part; and he recommended that none of the taxes of the underlying companies be paid unless and until otherwise ordered by the Court.

Whatever may be the technical legal relationship existing between Pittsburgh Railways Company and its underlying street railway and incline plane companies, in point of fact and for all practical purposes all those companies have been operated as a single and unified transportation system since 1902, and they are now being operated as such by the Trustees of Pittsburgh Railways Company, debtor. The [fol. 130] operation of the business of the several companies as a unified system was brought about by the voluntary action of those companies.

The plan of reorganization being developed by the two Trustees of the debtor who were directed to prepare and file a plan of reorganization for the debtor contemplates the formation of a new company which will acquire title to the properties of the underlying companies included in the Pittsburgh Railways Company transportation system and the operation thereof by the new company as a unified system. At the hearing before the Special Master, W. D. George, one of the reorganization Trustees, testified that most of the properties which are now in use will continue in use in the reorganized system.

Taxes Against the Debtor or Its Trustees

The Master recommended payment in full of all taxes owing by the debtor or its Trustees concerning which instructions were asked, except Federal Income Tax withheld at source for the years 1937 and 1938 and Pennsylvania Corporate Loans Tax for the year 1938, and these particular taxes, after a consideration of certain technical features involved, he recommended be paid only in part. It is true that some technical questions are involved with respect to these particular taxes, but in our opinion they should not be allowed to control the basic fact that the full amount of the taxes became due and payable subsequent to May 10, 1938, the date of filing of the debtor's petition, and are, therefore, expenses of administration, and for that reason, as well as for the reasons hereinafter stated as to why underliers' taxes should be paid, these particular taxes likewise should be paid in full by the Trustees. Florida National Bank of Jacksonville vs. United States, 87 Fed. (2d) 896; Prudential Insurance Co. of America [fol. 131] vs. Liberdar Holding Co., 74 Fed. (2d) 50; People of Michigan vs. Michigan Trust Co., 286 U. S. 334, 52 S. Ct. 512.

Taxes Against Underlying Companies

The reasons stated by the Master in support of his recommendation with respect to the taxes of underlying companies appear in paragraph 24 of his report, wherein he says:

"It is uncertain that any of the leases or operating agreements will ever be accepted by the trustees. Unless they be accepted, their covenants for payment of taxes will not bind the estate to pay the taxes of the underlying companies as administration expenses. There is no showing that the amounts, if any, owing to the respective companies for the net earnings of their properties or for the use of their properties by the trustees are proportionate to their taxes or even that in every case they are as much as their taxes. Payments of taxes regarded as payments for such earnings or use might give some companies a greater proportion of their dues than others and might even overpay some. If the debtor's claims (paragraph 17) against some of the underlying companies be meritorious, they may affect the equities. There does not appear to be any exigency which

might justify the risk of effecting preferences or overpayments. It does not seem practicable to deal with the underliers' taxes in the mass, or to dispose of them separately upon the facts shown. At present the taxes of the underliers should not be paid by the trustees."

After careful consideration of the Master's report, and having had the benefit of the exhaustive briefs that were filed with the Court and the oral arguments made in Court [fol. 132] by counsel for interested parties at the hearing upon the exceptions filed to the Master's report, Counsel for the Trustees have come to the conclusion that the Master related the matter of the payment of the underliers' taxes too closely to payments that might possibly be due underlying companies on account of use and occupancy of their properties. In other words, he did not, in our opinion, attach sufficient importance to the fact that the properties of the underlying companies are in the possession of the Trustees and are being used and operated by them with properties of the debtor as a unified system, and therefore the taxes of the underlying companies are, in effect, taxes of the unified system and, as such, operating and administrative expenses of the Trustees; and also that the Master was in error in concluding that it was not practicable to deal with the underliers' taxes in the mass. Moreover, with respect to public utility companies, the measure of the value of the use and occupancy of the properties during the administration by receivers or trustees is held to be the net earnings derived from the properties during the period, and it should be noted that it was testified at the hearing before the Master that it is not possible to determine the net earnings of the separate underliers in the Pittsburgh Railways system. We have found no case in which it was decided that a receiver or a trustee of a railway company should not pay the taxes of an underlying company included as part of a railway system being operated by the receiver or trustee unless the net earnings of the underlying company were equal to or in excess of the amount of such taxes.

It is very important to note that at the hearing before the Court upon the exceptions to the Master's report, 45 underlying companies, including all the important underliers in the Pittsburgh Railways system, urged payment of [fol. 133] the underliers' taxes in the mass, without regard

to whether the taxes paid for any underlier might ultimately exceed the amount, if any, which said underlier would be entitled to receive for use and occupancy of its properties by the Trustees. It is therefore apparent that the underlying companies, comprising by far the major part of the system, recognize that they function as part of a unified transportation system, and that with respect to operating expenses they are to be dealt with, not as units or individually but in the mass,—that from an operating standpoint, they have no separate identity. The Master did not have the advantage of this expression of the attitude of such a great number of the underliers when this matter was before him.

All taxes against the underlying companies concerning which recommendations were made by the Master were taxes which became due and payable subsequent to May 10, 1938, the date of the filing of the debtor's petition herein.

In our opinion, all taxes of underlying companies should be paid in full by the Trustees of the debtor as an administration expense (subject to the qualifications hereinafter stated with respect to Federal Income Taxes for the year 1938 and State Corporate Net Income Taxes for the years 1937 and 1938) for the following reasons:

1. The properties of the debtor and of the underlying companies since 1902 have been and are now being operated as a unified transportation system for the benefit of all, and the revenues produced from the operation of these properties have always been expended for the maintenance and operation of the system as a whole, without regard to the particular source of the revenues. No attempt was ever made to account for what revenues or earnings, if any, were produced by the operation of the properties of any particular underlier. It would seem to be clearly inequitable [fol. 134] for the Trustees to pay taxes of the debtor from revenues unquestionably produced in large part from the operation of underliers' properties and not to pay the taxes of the underliers. The Trustees are, moreover, out of the common funds, maintaining and keeping in repair all of the properties, purchasing equipment and supplies for the system, paying wages and salaries and all other operating expenses, and, on equitable grounds alone, there would seem to be no reason to discriminate with respect to the taxes of the system.

2. It is well settled that taxes accruing upon estates in the hands of receivers or trustees are payable as administration expenses, and that the interest and penalties accruing by reason of delay in payment are likewise payable. In re Preble Corporation, 15 Fed. Supp. 775; Coy vs. Title Guarantee & Trust Co., 220 Fed. 90; People of Michigan vs. Michigan Trust Co., 286 U. S. 334; 52 S. Ct. 512; Ingels vs. Boteler, 100 Fed. (2d) 915. Although the underlying companies as corporate entities are technically not before the Court in the reorganization proceeding, their properties are, nevertheless, in the possession of the Trustees pursuant to an Order of this Court, and the Trustees are operating said properties and exercising the franchises of the underlying companies in connection with and as part of the operation of the debtor's business. Therefore, in a very real sense and, we believe, in a legal sense, their properties are part of the estate being operated and administered by the Trustees of the debtor and their taxes are as much administration expenses as the debtor's own taxes.

3. If the taxes of underliers are not paid, interest will continue to accrue thereon,—in some instances at as high a rate as 12% per annum,—and will, no doubt, become liens against the underliers' properties. As hereinbefore stated, the reorganization trustees contemplate that under the plan which they propose to file, a new company is to acquire all [fol. 135] the properties of the debtor and its underliers. It would seem, therefore, that any taxes which are owed by the underlying companies or which may have become liens against their properties would ultimately have to be dealt with.

4. From the beginning of this proceeding the Trustees have been paying real estate taxes assessed against underlying companies by Allegheny County, the City of Pittsburgh and other municipalities. As the legal objections which are made to the payment of the other taxes of underliers herein considered do not appear to be persuasive, it would seem to be fair and equitable to accord like treatment to all taxing authorities.

5. The Trustees have in their possession sufficient cash funds derived from the operation of the system with which to pay in full, with any penalties or interest that may have

accrued thereon, all taxes the payment of which is recommended herein.

Qualifications With Respect to Underlying Companies' Federal Income Taxes for the Year 1938 and State Corporate Net Income Taxes for the Years 1937 and 1938

As to Federal Income Taxes of the underlying companies for the year 1938 which became due and payable in installments on and after March 15, 1939, attention is called to the fact that a part of the taxes in this group are produced by reason of the fact that the Philadelphia Company paid certain sums of money to or for the account of certain underlying companies in discharge of rental obligations under certain leases of properties heretofore operated by the debtor and now operated by the Trustees; and such payments have created taxable income to the underlying companies receiving such payments. While it is true that the [fol. 136] Pittsburgh Railways Company had contracted to pay the rental obligations and that the position of the Philadelphia Company with respect thereto is that of a guarantor, yet the Trustees have not affirmed these leases. It would therefore seem that the payments made by the Philadelphia Company were in discharge of its own obligations and not those of the Trustees. Since the Trustees are not paying any rentals to underlying companies, it does not seem fair and equitable to apply the general funds in the hands of the Trustees produced by all the underliers for payment of an income tax liability which would not have existed except for the performance of the obligations of the Philadelphia Company.

As to the second installment of State Corporate Net Income Tax for the year 1937 which became due and payable May 15, 1938, and as to the State Corporate Net Income Tax for the year 1938 which became due and payable in installments April 15, 1939 and May 15, 1939, respectively, we are of the opinion that these taxes should not be paid at this time for the reason that liability of the underlying companies therefore is disputed and a controversy with respect thereto is now pending.

Taxes Against Pittsburgh Motor Coach Company or Its Trustees

As to the taxes of Pittsburgh Motor Coach Company or its Trustees, the Master has recommended payment of said

taxes in full, with any penalties and interest which may have accrued thereon, except as to Social Security Tax, Title VIII (old age benefit—employer's share), owing by Pittsburgh Motor Coach Company for the first quarter of 1938. In our opinion, the Master's conclusions with respect to all the taxes under this heading are correct. The one item which he recommended be not paid is, obviously, a tax [fol. 137] which became due and payable prior to May 10, 1938 and is simply a debt of Pittsburgh Motor Coach Company.

Our Recommendations

I. The Master has recommended that the Trustees of the Pittsburgh Railways Company and of the Pittsburgh Motor Coach Company be instructed to pay the following taxes owing or to become owing, together with any penalties and interest which may have accrued thereon. Our recommendation with respect to each of said taxes is set forth under the particular tax.

(a) Federal Income Tax withheld at the source in respect to interest paid by the trustees.

We recommend payment of this tax.

(b) Federal Social Security Tax, Title VIII (old age benefit) for 1939 on employes of the trustees, deductible from wages.

We recommend payment of this tax.

(c) Federal Social Security Tax, Title VIII (old age benefit) for 1939 in respect to employes of the trustees.

We recommend payment of this tax.

(d) Federal Social Security Tax, Title IX (unemployment compensation) for 1939 in respect to employes of the trustees.

We recommend payment of this tax.

(e) Pennsylvania Capital Stock Tax upon Pittsburgh Railways Company and upon Pittsburgh Motor Coach Company for 1938 due in 1939.

We recommend payment of this tax.

[fol. 138] (f) Pennsylvania Corporate Net Income Tax upon Pittsburgh Railways Company or Pittsburgh Motor

Coach Company or the trustees, if any, for 1938, on income earned after May 10.

We recommend payment of this tax, if any. It is our understanding no tax is owing.

(g) Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by the trustees.

We recommend payment of this tax.

(h) Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by debtor whether on its own obligations or upon the obligations of others, to the extent that the tax was actually deducted by the paying agent from the interest paid and was returned by such agent to the debtor and deposited in debtor's account in Farmers Deposit National Bank, about $302.

We recommend payment of the full tax respecting interest paid by debtor whether upon its own obligations or upon the obligations of others, and do not limit our recommendation only to the tax that was actually deducted by the paying agent from the interest paid and returned by such agent to the debtor.

(i) Pennsylvania Social Security Tax (unemployment compensation) for 1939 in respect to employes of the trustees.

We recommend payment of this tax.

II. The Master has recommended that the Trustees of the Pittsburgh Railways Company and of the Pittsburgh Motor Coach Company be instructed to refrain from pay- [fol. 139] ing the following taxes unless and until otherwise ordered by the Court. Our recommendation with respect to each of said taxes is set forth under the particular tax.

(a) Federal Income Tax for 1937 withheld at the source in respect to interest paid by debtor.

We recommend payment of this tax.

(b) Federal Income Tax for 1938 withheld at the source in respect to interest paid by debtor.

We recommend payment of this tax.

(c) Pennsylvania Corporate Loans Tax for 1938 respecting interest paid by debtor, except so much of said tax as

was deducted and retained from interest and returned by the paying agent to the debtor and deposited in its account in the Farmers Deposit National Bank.

We recommend payment of the tax in full.
See our recommendation at I (h).

(d) Social Security Tax, Title VIII (old age benefit) owing by Pittsburgh Motor Coach Company for the first quarter of 1938.

We do not recommend payment of this tax.

(e) All United States taxes and Pennsylvania taxes against underlying companies.

We recommend payment of these taxes with the following qualifications:

1 As to Federal Income Taxes of the underlying companies for the year 1938, we recommend payment of said taxes except to the extent it may be determined that such taxes were produced by reason of payments made to un- [fol. 140] derlying companies by the Philadelphia Company in discharge of its obligations as guarantor of the performance of lease covenants.

2. As to State Corporate Net Income Taxes, we recommend that the taxes be not paid unless and until it should be determined that the underlying companies are liable therefor.

Respectfully submitted, Blaxter, O'Neill & Houston,
Counsel for the Trustees.

[fol. 141] IN UNITED STATES DISTRICT COURT

STIPULATION RE ADDITIONAL PARTS OF RECORD ON APPEAL—
Filed December 29, 1939

It is hereby stipulated that the following additional portions of the record shall be printed in the Record on Appeal in the Appeals of the City of Pittsburgh and the Tort Creditors' Committee from the Order of the above Court dated October 26, 1939, directing the payment of certain taxes:

1. The following docket entries relevant to the appeals in addition to those which have been heretofore designated by the appellants:

Dec. 11, On petition order made authorizing the City of Pittsburgh and the Tort Creditors Committee to print in the record on appeal from the order of Court of Oct. 26, 1939, directing the Trustees of the debtor company to pay certain taxes, only the docket entries set forth in Exhibit "A" attached to petition, in lieu of the docket entries on the record except such other docket entries as the appellees may designate with the approval of the Court.

Dec. 11, Acceptance of service of notice as to printing the record on appeal filed.

Dec. 13, Statement of Appellants' (City of Pittsburgh and the Tort Creditors' Committee) Points on Appeal filed. [fol. 142] Dec. 13, Designation of Contents of Record on Appeal (City of Pittsburgh and Tort Creditors' Committee) filed.

Dec. 13, Transcripts of Testimony (2) taken March 28, 1939 at hearing on Petition of Trustees Respecting Taxes and Adjournments thereof, filed.

Dec. 14, Acceptance of service of notice of filing Designation of Contents of Record on Appeal and Statement of Points, filed.

Dec. 22, Recommendations of counsel for trustees relative to Trustees' Petition for Instructions with Respect to Certain Taxes filed.

Dec. 22, Designation of Additional Portions of the Record, proceedings and Evidence to be included in the Record on Appeal and Notice and Acceptance of Service filed.

Dec. 22, Order made directing that the time for filing of the record on appeal with the Clerk of the Circuit Court of Appeals in the appeals of the City of Pittsburgh and the Tort Creditors Committee from an order entered by this Court on Oct. 26, 1939 be extended from Jan. 4, 1940 to Jan. 18, 1940, provided that both the typewritten and printed record be filed on or before Jan. 18, 1940.

Dec. 22, On petition order made directing that there be filed and docketed in the office of the Clerk and made a part of the record in this proceeding the "Recommendation of Counsel for Trustees Relative to Trustees Petition for Instructions with Respect to Certain Taxes" which Blaxter, [fol. 143] O'Neill & Houston filed with McVicar, J. person-

ally on or about October 20, 1939, which document does not appear to have heretofore been filed and docketed in the office of the Clerk of this Court.

Same day exception noted to City of Pittsburgh and Tort Creditors Committee.

Dec. 29, Stipulation of counsel as to additional portions of the record that shall be printed in the Record on Appeal in the appeals of the City of Pittsburgh and the Tort Creditors' Committee, filed.

2. Order of Court dated December 22, 1939, extending the time for filing the Record on Appeal and the stipulation of counsel for the City of Pittsburgh and for the Tort Creditors' Committee appended thereto.

3. Order of Court dated December 22, 1939, directing that there be filed and docketed in the office of the Clerk of the Court, and made a part of the record in the proceeding, the "Recommendations of Counsel for Trustees Relative to Trustees Petition for Instructions with Respect to Certain Taxes," and the exception thereto.

4. Trustees designation of additional portions of the record, proceedings and evidence to be included in the Record on Appeal, filed December 22, 1939.

5. The "Recommendations of Counsel for Trustees Relative to Trustees' Petition for Instructions with Respect to Certain Taxes," without prejudice to the right of the City of Pittsburgh and the Tort Creditors Committee, Appellants, to urge the exception noted to them on the Order of Court dated December 22, 1939, directing that there be filed [fol. 144] and docketed in the office of the Clerk of the Court and made part of the record in the proceeding the aforesaid "Recommendations."

6. The within stipulation.

Leon Wald, Attorney for City of Pittsburgh. A. E. Kountz, Lewis M. Alpern, Attorneys for Tort Creditors Committee. Blaxter, O'Neill & Houston, Attorneys for Trustees. Reed, Smith, Shaw & McClay, by W. A. Seifert, Attorneys for Philadelphia Company and Underliers.

[fol. 145] Clerk's Certificate to foregoing transcript omitted in printing.

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104

[fol. 146] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

In the Matter of the Reorganization of PITTSBURGH RAILWAYS COMPANY, Debtor, and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

No. 7271. Appeal of Tort Creditors' Committee

No. 7283. Appeal of City of Pittsburgh

And afterwards, to wit, the 6th day of March, 1940, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Albert B. Maris, Honorable William Clark and Honorable Charles Alvin Jones, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 30th day of April, 1940, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 147] IN THE UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE THIRD CIRCUIT

Nos. 7271 and 7283. October Term, 1939

In the Matter of the Reorganization of PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary

Appeals of Tort Creditors' Committee and of City of Pittsburgh, Creditors

Appeals From the District Court of the United States, for the Western District of Pennsylvania

OPINION—Filed April 30, 1940

Before MARIS, CLARK and JONES, Circuit Judges

MARIS, Circuit Judge.

These are appeals from an order of the District Court for the Western District of Pennsylvania directing the

trustees of Pittsburgh Railways Company, a debtor in reorganization under Chapter X of the Bankruptcy Act and of Pittsburgh Motor Coach Company, a subsidiary, to pay as an administration expense taxes assessed against fifty-five underlying companies whose properties under lease and operating agreements form part of the Pittsburgh [fol. 148] Railways System. A schedule of the taxes involved in this appeal is set out below.[1]

None of the taxes listed in the schedule was assessed against the debtor or its subsidiary and none bears any relation to the properties leased by the underliers to the debtor. Each is a tax upon the income of the underliers or upon their capital stock or securities. In other words, although they are taxes due and owing by the underliers to the state and federal governments, they are not taxes due and owing by the debtor. The sole obligation of the debtor with respect to these taxes arose under the leases and operating agreements with the underliers which provided that the debtor should pay all taxes assessed against the underliers. The obligation of the debtor to pay the

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[1] Unpaid balances of Federal Income Taxes of the underliers for the year 1937 ..... $97,412.14
Federal Income taxes for the year 1937 withheld at source in respect to interest upon the obligations of underliers 6,850.01
Pennsylvania Corporate Net Income taxes of the underliers for the year 1937 ..... 27,639.59
Federal Income taxes of the underliers for the year 1938 ..... 50,501.26
Federal Income taxes for the year 1938 withheld at source with respect to interest upon the obligations of underliers 2,668.08
Pennsylvania Corporate Net Income taxes of the underliers for the year 1938 ..... 18,335.72
Pennsylvania Capital Stock taxes of the underliers for the year 1938 ..... 64,294.57
Pennsylvania Corporate Loans taxes for the year 1938 in respect to interest upon the obligations of the underliers 17,502.56

Total $285,203.93

[fol. 149] taxes was an additional consideration for its use of the underliers' property, and, therefore, as to it a rental obligation rather than a tax liability.[2]

The appellees argue that since the properties of the underlying companies are in the possession of the trustees of the debtor and are being used and operated by them with properties of the debtor as a unified system the taxes of the underlying companies are, in effect, taxes of the unified system and are, therefore, operating and administrative expenses of the trustees.[3] The district court adopted this view.

We are asked to ignore the legal relationships existing between the Philadelphia Company,[4] the debtor and the underliers[5] and their separate corporate identities and treat them all as one unified transportation system. For all practical purposes, the appellees argue, the separate identity of the underlying corporations has been lost. We are not impressed with the equity of this plea. Under other circumstances the appellee, the Philadelphia Company, has not sought to ignore its corporate identity but has taken refuge behind it to escape liability upon an underlier's

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[2] Hardeman v. Hendrix, 29 F. 2d 738.

[3] The trustees state:

"We do not contend these taxes are payable because the debtor contracted to pay them. While such contracts exist, thus far the Trustees have not affirmed them and may never do so. Whatever might be the effect of affirmance of the operating agreements and leases on the obligation of the Trustees to the underliers, we submit that the obligation of the Trustees to the taxing authorities is not governed by those contracts or by any action that might be taken by the Trustees with respect to them. Nor do we contend these taxes are payable as compensation for use and occupancy of the underliers' properties by the Trustees."

[4] The Philadelphia Company is the holding company which owns all the stock of the debtor.

[5] The debtor has an investment of approximately $32,000,000 in the stock of the underliers.

[fol. 150] bond,[6] as has also the debtor[7] and an underlier.[8] The appellees, the Philadelphia Company and the underliers, appear not too sincere in their contention that the corporate form is merely fiction when it is observed that the underliers have refrained from themselves filing petitions for reorganization, with the result that the only corporations in the system which are in process of reorganization are the debtor and its subsidiary. The Trustees are not trustees for the Philadelphia Company nor for any of the underliers. Neither the past history of the system nor the present state of the reorganization proceedings would, we think, justify our ignoring the existence of the separate legal entities which compose that system.

A number of the taxes here involved became due prior to the filing of the petition for reorganization on May 10, 1938. These are the federal income taxes for 1937 and federal income taxes for 1937 withheld at source, due March 15, 1938[9] and the Pennsylvania net income taxes for 1937, due April 15, 1938.[10] Even though the taxpayer was given the option to pay these taxes in installments the taxes were actually due on the dates mentioned, which were the dates fixed by law for filing the tax returns. The failure of the debtor to pay these taxes was a breach of the leases and operating agreements and the amounts then due became simple contract claims against the debtor, due when the debtor's petition was filed.[11] As to these claims [fol. 151] the underliers must take their position with all other general creditors.

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[6] Allen v. Philadelphia Co., 265 F. 807, affirmed 265 F. 817. Cf. Ambridge Borough v. Philadelphia Co., 283 Pa. 5, 129 A. 67.

[7] Sec. Ave. T. Co. v. U. T. Co. of PBG., 328 Pa. 257, 195 A. 25.

[8] Lyon v. Pitts. A. & M. Tr. Co., 312 Pa. 584, 169 A. 229.

[9] Revenue Act of 1936, c. 690, § 53, 26 U. S. C. A. § 53(a)1; Act of May 10, 1934, c. 277, § 143(c), 26 U. S. C. A. § 143(c).

[10] Pennsylvania Act of May 16, 1935, P. L. 208, § 4, as amended, 72 P. S. § 3420(d).

[11] Philadelphia & Reading Coal & Iron Co. v. Van Deusen, 103 F. 2d 869.

A different question is presented by the taxes for 1938 since they became due while the trustees were actually administering the debtor's estate and making use of the properties of the underliers in such administration.

The trustees have no obligation to pay the rentals due under the leases, as such, unless and until they affirm the leases and operating contracts. They have a reasonable time within which to affirm or disaffirm. During the interim their sole obligation is to pay the lessors a reasonable amount for the use and occupation of the properties actually in use.[12] This rule, which was originally laid down in railroad receiverships in equity applies to the reorganization of a street railway under Section 77B of the Bankruptcy Act.[13] If an interim payment is made it is ordinarily held that it should not be in an amount in excess of the net earnings derived from the operation if the lessor's properties.[14]

It may be, as argued by the appellees, that in this case it is impossible fairly to allocate the net earnings of the system to the various leased lines. In that case it may be necessary for the court to fix an allowance for use and occupation upon the basis of the fair value of the property actually used by the trustees. This we need not now determine for the court must first determine the property which is being used, the extent of its use and the net earnings being derived from it or its value.[15] Until that is done any [fol. 152] order made by the court would have no factual basis and would, therefore, be arbitrary and possibly confiscatory.

It is urged that unless the taxes are paid immediately irreparable harm may result, since the taxing authorities may distrain. If and when this situation arises and the dis-

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[12] United States Trust Co. v. Wabash Railway, 150 U. S. 287; Pennsylvania Steel Co. v. New York City Ry. Co., 198 F. 721; American Brake Shoe & Foundry Co. v. New York Rys. Co., 282 F. 523; Westinghouse Electric & Mfg. Co. v. Brooklyn Rapid T. Co., 6 F. 2d 547.

[13] In re Connecticut Co., 95 F. 2d 311, cert. den. sub nominee Connecticut Railway & Lighting Co. v. Connecticut Co., 304 U. S. 571.

[14] Supra—note 12.

[15] Public Service Commission v. Philadelphia Rapid T. Co., 82 F. 2d 481.

trict court deems such a distraint undesirable and likely to hinder the reorganization it may utilize the powers conferred upon it and enjoin all the proceedings to enforce the lien of any distraint made upon any property in which the debtor has an interest.[16] However, the record before us does not justify a conclusion that the taxing authorities intend to distrain without leave of court. The court may properly withhold such leave pending determination of such vital questions to the reorganization as whether the trustees plan to affirm or disaffirm the leases, which of the underliers are to become part of the new transportation unit and whether the debtor's counterclaims against the underliers to which reference is made in the master's report are enforceable.

An impressive array of authorities is cited by the appellees to the effect that taxes are to be given preference in a proceeding such as this. We, however, are dealing with a contractual liability of the debtor, whereas in each of the cited cases[17] the obligation was a genuine tax liability of the corporation itself and not as in the present case an obligation to pay the taxes of some other corporation.

The appellees give much weight to the fact that the trustees have in their possession funds derived, as they allege, almost wholly from the operation of the underliers' property, sufficient to pay all the taxes. They contend that [fol. 153] it is wasteful of the trust estate to permit interest and penalties to accumulate by reason of non-payment of these taxes. If, however, by reason of the ultimate disaffirmance of the leases the taxes should never become payable, as such, out of the debtor's estate and if the amount claimed as taxes should be found to exceed the sum justly due for use and occupation the trustees would be in error in so applying the funds in their possession. Furthermore the debtor may succeed in substantiating its claims against some of the underliers.

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[16] 11 U. S. C. A. §516(4).

[17] Michigan v. Michigan Trust Co., 286 U. S. 334; Coy v. Title Guarantee & Trust Co., 220 F. 90; Bear River Paper & Bag Co. v. City of Petoskey, 241 F. 53; MacGregor v. Johnson-Cowdin-Emmerich, Inc., 39 F. 2d 574; Hardee v. American Security & Trust Company, 77 F. 2d 382.

Enough has been said to demonstrate that the order of the district court cannot be sustained upon the record before us. It is accordingly

Reversed.

A true Copy. Teste:

——— ———, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 154] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7271

In the Matter of the REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, Debtor, and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

APPEAL OF TORT CREDITORS' COMMITTEE

Appeal from the District Court of the United States, for the Western District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order of October 26, 1939 of the said District Court in this cause be, and the same is hereby reversed; costs of this appeal to be paid out of the Debtor's estate.

Philadelphia, April 30, 1940.

Albert B. Maris, Circuit Judge.

Endorsements: Order Reversing Order of Oct. 26, 1939 etc. Received & Filed Apr. 30, 1940. William P. Rowland, Clerk.

[fol. 155] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7283

In the Matter of the REORGANIZATION OF PITTSBURGH MOTOR COACH COMPANY, Debtor, and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

APPEAL OF CITY OF PITTSBURGH

Appeal from the District Court of the United States, for the Western District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order of October 26, 1939 of the said District Court in this cause be, and the same is hereby reversed; costs of this appeal to be paid out of the Debtor's estate.

Philadelphia, April 30, 1940.

Albert B. Maris, Circuit Judge.

Endorsements: Order Reversing Order of Oct. 26, 1939 etc. Received & Filed Apr. 30, 1940. William P. Rowland, Clerk.

[fol. 156] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7271

In the Matter of the Reorganization of PITTSBURGH RAILWAYS COMPANY, Debtor, and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

Appeal of Tort Creditors' Committee

ORDER VACATING DECREE

It is hereby ordered that the decree, or order of reversal, of this Court entered on April 30, 1940 be and the same is hereby vacated.

Philadelphia, June 12, 1940.

Albert B. Maris, Circuit Judge

Endorsements: Order vacating decree of April 30, 1940. Received & filed June 12, 1940. Wm. P. Rowland, Clerk.

[fol. 157] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7283

In the Matter of the Reorganization of PITTSBURGH RAILWAYS COMPANY, Debtor, and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

Appeal of City of Pittsburgh

ORDER VACATING DECREE

It is hereby ordered that the decree, or order of reversal, of this Court entered on April 30, 1940 be and the same is hereby vacated.

Philadelphia, June 12, 1940.

Albert B. Maris, Circuit Judge

Endorsements: Order vacating decree or order of April 30, 1940. Received & filed June 12, 1940. Wm. P. Rowland, Clerk.

[fol. 158] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7271

In the Matter of the Reorganization of PITTSBURGH RAILWAYS COMPANY, Debtor and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

APPEAL OF TORT CREDITORS' COMMITTEE

Appeal from the District Court of the United States, for the Western District of Pennsylvania

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order of October 26, 1939 of the said District Court in this cause be, and the same is hereby reversed in so far as it directs the payment

of the taxes involved in this appeal; costs of this appeal to be paid out of the Debtor's estate.

Philadelphia, June 12, 1940.

Albert B. Maris, Circuit Judge.

Endorsements: Amended Order Reversing District Court Order of Oct. 26, 1939. Received & Filed. June 12, 1940. William P. Rowland, Clerk.

[fol. 159] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7283

In the Matter of the Reorganization of PITTSBURGH RAILWAYS COMPANY, Debtor and PITTSBURGH MOTOR COACH COMPANY, Subsidiary

APPEAL OF CITY OF PITTSBURGH

Appeal from the District Court of the United States, for the Western District of Pennsylvania

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order of October 26, 1939, of the said District Court in this cause be, and the same is hereby reversed in so far as it directs the payment of the taxes involved in this appeal; costs of this appeal to be paid out of the Debtor's estate.

Philadelphia, June 12, 1940.

Albert B. Maris, Circuit Judge.

Endorsements. Amended Order Reversing District Court Order of Oct. 26, 1939. Received & Filed June 12, 1940. William P. Rowland, Clerk.

[fol. 160] UNITED STATES OF AMERICA,

Eastern District of Pennsylvania,
Third Judicial Circuit, Sct.:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify

he foregoing to be a true and faithful copy of the original Transcript of Record and proceedings in this court in the matter of the Reorganization of Pittsburgh Railways Company, Debtor, and Pittsburgh Motor Coach Company, Subsidiary—No. 7271 Appeal of Tort Creditors' Committee, No. 7283 Appeal of City of Pittsburgh, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 26th day of June in the year of our Lord one thousand nine hundred and forty and of the Independence of the United States the one hundred and sixty-fourth.

Wm. P. Rowland, Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

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[fol. 161] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1940

No. 242

ORDER ALLOWING CERTIORARI—Filed October 14, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following No. 120.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 162] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1940

No. 243

ORDER ALLOWING CERTIORARI—Filed October 14. 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following No. 242.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsed on cover:] File Nos. 44,591, 44,592. U. S. Circuit Court of Appeals, Third Circuit. Term No. 242. Philadelphia Company and Certain Underliers, Petitioners, vs. Walter L. Dipple, James P. McArdle, Ben Paul Brasley and Thomas J. Hoffman, etc., et al. Term No. 243. Philadelphia Company and Certain Underliers, Petitioners, vs. Walter L. Dipple, James P. McArdle, Ben Paul Brasley and Thomas J. Hoffman, etc., et al. Petition for writs of certiorari and exhibit thereto. Filed July 15, 1940. Term Nos. 242 O. T. 1940, 243 O. T. 1940.

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FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NO..... 242 - 243

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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SMITH BROS. CO. INC., LAW PRINTERS, 208-212 GRANT STREET, PITTSBURGH, PA.

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INDEX.

Cases Cited.

Cases Cited.

Statute Cited.

Constitution of the United States.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NO.....

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

The undersigned, on behalf of Philadelphia Company, owner of all of the capital stock and principal creditor of the above named debtor, and on behalf of certain underliers listed below,* as petitioners, pray that

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* Allegheny, Bellevue and Perrysville Railway Company; The Allenport and Roscoe Electric Street Railway Company; Ben Avon and Emsworth Street Railway Company; Bon-Air Street Railway Company; Cedar Avenue Street Railway Company; East McKeesport Street Railway Company; Glenwood and Dravosburg Electric Street Railway Company; The McKeesport and Reynoldton Passenger Railway Company; Mt. Washington Street Railway Company; Mt. Washington Tunnel Company; Pittsburgh, Allegheny, and Manchester Passenger Railway Company; The Pittsburgh, Allegheny and Manchester Traction Company; Pittsburgh and Charleroi Street Railway Company; Pittsburgh and West End Railway Company; Pittsburgh, Canonsburg and Washington Railway Company; Pittsburgh, Crafton and Mansfield Street

writs of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled case.

Summary Statement of the Matter Involved.

Since 1902, Pittsburgh Railways Company, debtor, has been in possession of and has occupied, used and held properties of approximately fifty-five street railway companies (hereinafter referred to as "underliers"), which properties, in conjunction with its own properties, the debtor has operated as a unified street railway transportation system in and about the City of Pittsburgh, Pennsylvania, the system being known as the Pittsburgh Railways System (R. 8, 9, 55, 83). The underliers' properties were in possession of the debtor under certain leases and operating agreements which require the debtor to pay expenses of operation and ordinary maintenance and all taxes of the underliers (R. 9, 10).

The Pittsburgh Railways System consists of approximately 560 miles of track, incline plane properties, cars and buildings used primarily for the housing of cars. The debtor itself owns 28 miles of track, cars and other

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Railway Company; Pittsburgh, Neville Island and Coraopolis Railway Company; Pittsburgh Union Passenger Railway Company; Second Avenue Passenger Railway Company; Second Avenue Traction Company; The Second Avenue Traction Company; Superior Avenue and Shady Avenue Street Railway Company; United Traction Company of Pittsburgh; Washington and Canonsburg Railway Company; West End Traction Company; West Liberty and Suburban Street Railway Company; West Shore Electric Street Railway Company; Consolidated Traction Company; Ardmore Street Railway Company; Central Passenger Railway Company; The Central Traction Company; Fort Pitt Traction Company; The Pittsburgh Traction Company; The Duquesne Traction Company; The Duquesne Street Railway Company; Federal Street and Pleasant Valley Passenger Railway Company; The Morningside Electric Street Railway Company; Seventeenth Street Incline Plane Company.

miscellaneous property (R. 108). The debtor has always paid, directly, the expenses of operation and ordinary maintenance and all taxes of the underliers. None of such payments have been made by the underliers (R. 9).

On May 10, 1938, the debtor filed a voluntary petition to effect a plan of reorganization under the provisions of Section 77B of the Bankruptcy Act, and on the same day the court approved the petition as properly filed and continued the debtor in possession with authority to operate its business (R. 1). By order entered June 14, 1938, the court appointed trustees of the debtor and its subsidiary, Pittsburgh Motor Coach Company, and authorized the trustees, *inter alia,* to

> "preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the debtor, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues, and profits of said property and estate; * * * and to pay all taxes and assessments due or to become due upon the property in possession and/or owned by the debtor." (R. 107)

Pursuant to their authority the trustees have since their appointment and qualification been operating the business of both debtor and the subsidiary, using in their operation the properties of the underliers. However, the trustees have neither affirmed nor disaffirmed the leases and operating agreements between the debtor and its underliers.

On March 10, 1939, the trustees of the debtor filed a petition with the District Court praying for instructions with respect to the payment of taxes of the underliers which became due and payable after the approval

of the debtor's original petition (May 10, 1938), together with certain other taxes of the debtor and its subsidiary not material herein (R. 8-26). The taxes of the underliers involved are set forth below.* The trustees' petition averred that at the date of filing the original petition, the cash on hand was $230,260.00, and on March 8, 1939, was $1,537,247.46, the latter amount being sufficient to pay all taxes as to which instructions were requested by the trustees (R. 16). None of the underliers had funds with which to pay any of the taxes assessed against them (R. 17).

The trustees' petition was referred to a special master for hearing and a report thereon (R. 26). At the hearing objections to the payment of the taxes of the underliers were filed by the Tort Creditors' Committee of the debtor (R. 28). Mr. Fitzgerald, one of the trustees who has been in active charge of the operation of the Pittsburgh Railways System since 1924, testified at the hearing that (a) since it was created in 1902 there has been absolutely no effort to account for reve-

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* Unpaid balances of Federal income taxes for the year 1937, payments due June 15, September 15, and December 15, 1938 — $ 97,412.14

Federal income taxes for the year 1937, withheld at source in respect to interest upon obligations of underliers, payment due June 15, 1938 — 6,850.01

Pennsylvania corporate net income taxes for the year 1937, payment due May 15, 1938 — 27,639.59

Federal income taxes for the year 1938 — 50,501.26

Federal income taxes for the year 1938, withheld at source with respect to interest upon the obligations of underliers — 2,668.08

Pennsylvania corporate net income taxes for the year 1938 — 18,335.72

Pennsylvania capital stock taxes for the year 1938 — 64,294.57

Pennsylvania corporate loans taxes for the year 1938 in respect to interest upon the obligations of underliers — 17,502.56

Total — $285,203.93

nues and operating expenses of individual underliers; (b) to attempt to account for revenues and operating expenses of individual underliers would be tremendously expensive, and the results would not furnish a dependable basis for allocating revenues; (c) the only way in which net earnings of each underlier could be determined would be to operate each individually, such individual operation being physically impossible and unsatisfactory to the public and to municipal and state authorities; and (d) at present he knows of no method of determining what relative rentals should be paid to the various underlying companies whose properties have been utilized by the debtor or its trustees since May 10, 1938 (R. 54, 55, 57). Mr. George, one of the trustees charged with the duty of preparing a plan of reorganization, testified that (a) he believes there will not be a great amount of abandonment of properties of the underliers in the reorganization; (b) he did not consider it practicable for the trustees to say what properties of the underliers will or will not be embraced in the contemplated plan of reorganiation; and (c) the properties of the underliers whose taxes were being considered are presently being operated by the trustees (R. 60-62).

The special master filed a report recommending, *inter alia*, that the taxes of the underliers should not be paid by the trustees (R. 89, 90). Exceptions were filed to the special master's report by Philadelphia Company (petitioner herein and principal creditor of and owner of all the capital stock of the debtor), and by certain underliers (R. 97-106). An argument on the exceptions of your petitioners herein was held before the District Court and, subsequent thereto, counsel for the trustees filed a statement with the District Court recommending the payment of all taxes of the underliers, except Federal income taxes in so far as such income taxes were produced by payments made to the underliers by Philadelphia Company in discharge of its obligations

as guarantor of the underliers' lease covenants and except Pennsylvania corporate net income taxes unless and until the liability of the underliers for such taxes should be determined (R. 129-140).

The District Court entered its opinion and order holding and directing that the underliers' taxes be paid to the extent recommended by counsel for the trustees (R. 107-116). From said order of the District Court, in so far as it directed payment of the underliers' taxes, the Tort Creditors' Committee and the City of Pittsburgh appealed to the Circuit Court of Appeals for the Third Circuit (R. 117-119). The appeals were heard together, and in its opinion filed April 30, 1940, the Circuit Court of Appeals reversed the District Court (R. 146-152). The orders of the Circuit Court entered April 30, 1940 (R. 152) were vacated and amended orders entered June 12, 1940 (R. 154, 155), in which it was directed that the order of the District Court be reversed in so far as it directed the payment of taxes involved in the appeals.

Jurisdiction.

The Circuit Court of Appeals entered its orders on April 30, 1940 (R. 152). On June 12, 1940, said orders were vacated (R. 153, 154), and amended orders were entered (R. 154, 155). No petition for rehearing was filed. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, Chap. 229, § 1, 28 U. S. C. A. § 347, since this is a cause in which final orders of a Circuit Court of Appeals have been entered.

Question Presented.

Where the trustees of a street railway company in reorganization under Section 77B and Chapter X of the

Bankruptcy Act are operating the business of the debtor, using the property of the debtor and properties of lessor or underlying street railway companies (comprising approximately 95% of the system's trackage) which properties have been operated as a unified system by the debtor since 1902 pursuant to leases and operating agreements requiring the payment by the debtor of all taxes assessed against such underlying companies, and the trustees take possession of, occupy and use the properties of the underlying companies, receive all revenues therefrom and use such revenues as a common fund with which to pay all operating charges of the system, such as wages, cost of supplies, repairs and improvements to the properties of the debtor and the underliers, insurance premiums, and for the purchase of new equipment, for a period of over two years without either affirming or disaffirming the leases and operating agreements, should the trustees be authorized and directed to pay the taxes legally levied against the underlying street railway companies which became due and payable, or which accrued, after the approval of the debtor's original petition, when the trustees are possessed of ample funds derived almost entirely from the use of said underlying companies' properties and none of the underliers have funds with which to pay any of said taxes?

Reasons Relied on for Allowance of the Writs.

1. The decision of the court below is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Webster & Atlas National Bank of Boston v. Palmer, et al.,* 111 Fed. (2d) 215, decided April 16, 1940, in which the court directed the trustees of the debtor to pay all taxes legally assessed by state and local authorities against the debtor's underliers so long as operation of the underliers' properties continued by the debtor's trustees. A petition for writ of certiorari

in the *Webster & Atlas* case was filed with this court on June 1, 1940.

2. In holding that the trustees of the debtor may not make payment of the underliers' taxes which became due and payable, or which accrued, after the approval of the debtor's original petition for reorganization, the Circuit Court of Appeals decided important questions of Federal law which have not been, but should be, settled by this court.

(a) The decision of the court below raises an important question with respect to the duty of trustees appointed under the Bankruptcy Act to pay taxes assessed against the business of a lessor or underlier of the debtor when such business is operated by the debtor's trustees pending the affirmance or disaffirmance of the lease. In no case has this court determined that question.

(b) The decision of the court below raises an important question as to the interpretation of the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. § 124a) which directs that any trustee appointed by any United States court who is authorized by said court to conduct any business shall be subject to all state and local taxes applicable to such business. Under the decision of the Circuit Court of Appeals, this Act would not be applicable to the taxes of a lessor or underlying company whose business was being conducted by the trustees of the debtor under authority of an order of the court.

(c) As so construed by the Circuit Court of Appeals there is a serious question whether this Act, in the light of the power of the debtor's trustees to retain possession of leased property until rejected by them, does not contravene the Fifth Amendment to the Constitution of the United States.

WHEREFORE your petitioners respectfully pray that writs of certiorari be issued out of and under the seal of this Honorable Court to the Circuit Court of Appeals for the Third Circuit, commanding that court to certify and send to this court, for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in this case; that the orders of the Circuit Court of Appeals for the Third Circuit may be reversed; and that your petitioners may have such other and further relief in the premises as to your Honorable Court may seem meet and just.

And your petitioners will ever pray, etc.

PHILIP A. FLEGER,
W. A. SEIFERT,
Attorneys for Philadelphia Company and Certain Underliers, Petitioners.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

Opinions Below.

The opinion of the District Court (McVicar, J.) has not yet been officially reported; it appears at pages 107 to 113 of the record. The opinion of the Circuit Court of Appeals (Maris, C. J.) is reported in 111 Fed. (2d) 932, and will be found at pages 146 to 152 of the record.

II.

Jurisdiction.

A statement of the grounds on which the jurisdiction of this court is invoked is contained in the petition.

III.

Statute Involved.

Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a):

> "Sec. 124a. STATE TAXATION: BUSINESS CONDUCTED BY RECEIVERS, TRUSTEES OR OTHER COURT OFFICERS SUBJECT TO
>
> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: *Provided, however,* That nothing in this section contained shall be construed to prohibit or prejudice the collection of any such

taxes which accrued prior to June 18, 1934, in the event that the United States court having final jurisdiction of the subject matter under existing law should adjudge and decide that the imposition of such taxes was a valid exercise of the taxing power by the State or States, or by the civil subdivisions of the State or States imposing the same."

IV.

Statement of the Case.

A statement of the essential facts of the case is included in the petition.

V.

Specification of Errors Intended to Be Raised.

The Circuit Court of Appeals erred:

1. In reversing the order of the District Court.

2. In holding that the taxes of the underliers which became due and payable after the approval of the debtor's original petition should not be paid by the trustees of the debtor.

3. In holding that the taxes of the underliers which accrued after the approval of the debtor's original petition should not be paid by the trustees of the debtor.

4. In requiring payment, in violation of the Fifth Amendment to the Constitution of the United States, of the debtor's taxes out of funds in the possession of the trustees derived largely from the operation of the underliers' properties while forbidding any payment of the underliers' taxes from those funds.

5. In holding that the court must first determine the property of the underliers which is being used, the extent of its use and the net earnings being derived from it or its value before any payment to the underliers on account of use and occupation can be permitted.

6. In holding that the only obligation of the debtor or of the trustees to pay taxes of the underliers is by virtue of covenants in the leases and operating agreements under which the debtor was in possession of the properties of the underliers.

7. In failing to treat the taxes of underliers as operating expenses entitled to payment as expenses of administration.

8. By failing to give proper effect to the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a).

VI.

Argument.

1. The decision of the court below is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in Webster & Atlas National Bank of Boston v. Palmer et al., 111 Fed. (2d) 215, decided April 16, 1940.

In the instant case the Circuit Court of Appeals held that the trustees of the debtor should not use funds in the estate of the debtor for payment of taxes of the underliers whose properties are being operated by the trustees of the debtor, together with the debtor's property, as a unified system. In the *Webster & Atlas* case the court directed the trustees of the debtor to pay all taxes legally assessed by state and local authorities against the debtor's underliers so long as operation of

the underliers' properties continued by the debtor's trustees.

In the *Webster & Atlas* case the trustees in reorganization of the New York, New Haven & Hartford Railroad Company rejected the leases of certain underlying lessor companies. The underliers being unequipped for independent operation, the District Court, pursuant to Section 77(c)(6) of the Bankruptcy Act, ordered the New Haven's trustees to continue operation of the underliers' properties. Under a segregation formula, accepted by the District Court, it appeared that the underliers' lines were operated at a loss, and it appeared, the Circuit Court so recognizing, that the continued diversion of funds from the New Haven's estate to meet these deficits of the underliers would jeopardize the New Haven's own creditors. Accordingly, the New Haven's trustees filed a petition asking for authority to withhold the further payment of taxes of the underliers. The Circuit Court of Appeals held that the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a) hereinafter referred to as "Sec. 124a", required the New Haven's trutees to pay the underliers' taxes so long as they operated the underliers' properties, saying:

> "28 U. S. C. A. § 124a, enacted in 1934, declares that 'Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation * * *.' This section was applied generally, even against the bankruptcy trustee's claim of lack of funds, in Ingels v. Boteler, 9 Cir., 100 F. 2d 915, affirmed 308 U. S. 57, 60 S. Ct. 29, 84 L. Ed. . . . . And it was held applicable to a

railroad's trustee under § 77. Thompson v. Louisiana, 8 Cir., 98 F. 2d 108, 111.

"The district court held, however, that even if this statute ordinarily applied to railroad trustees, yet it did not apply when such officers were operating only for account of a lessor road under § 77, sub. c (6). But we believe that, since that statute has placed the duty of operation upon the lessee, the lessee's trustees are thereby made 'agents of the court' within the meaning of 28 U. S. C. A. § 124a. The Old Colony and the Boston and Providence, were they operating their lines, would have to pay their share of the taxes levied against the Boston Terminal Company. Section 25 of the Massachusetts statute of 1896 makes them directly liable to the tax collector for the real estate taxes, and their duty under § 10 of the same Act to pay all other taxes to the Terminal Company could be enforced directly by the taxing authorities. Now by law the duties of operation have devolved upon the New Haven, as lessee, and upon the New Haven trustees. If there existed sufficient moneys of the Old Colony and the Boston and Providence, no one could gainsay the duty of the New Haven trustees to apply those moneys to payment of the taxes. In accordance with the view we have expressed above —that operation must continue until abandonment has been legally ordered, even though the New Haven trustees must go for funds to the New Haven estate—*we conclude that under 28 U. S. C. A. § 124a taxes legally assessed by state and local authorities must be paid by the New Haven trustees while operation continues.*" 111 Fed. (2d) 219, 220. (Italics supplied)

In the instant case, the Circuit Court of Appeals, in holding that the trustees of the debtor should not pay the taxes of the underliers, stated as its reasons therefor

that (a) the taxes in question are taxes of the underliers, not of the debtor, and are owing by the debtor only as a contractual obligation under the leases and operating agreements and then only if the trustees affirm the leases and operating agreements; (b) the trustees are not trustees of the underliers; (c) payment of the taxes is not immediately necessary to prevent harmful action by the taxing authorities against the properties of the underliers; and (d) payment of these taxes cannot be justified as a partial allowance for use and occupancy prior to affirmance or rejection of the leases and operating agreements unless it is first determined what is a fair allowance on the basis of revenues derived from or of the fair value of the property of the underliers being used, since otherwise, to the extent that the amount paid as taxes exceeded sums justly due for use and occupation, funds of the debtor would be diverted to the preference of the underliers over the creditors of the debtor.

The same situation, in effect, existed in the *Webster & Atlas* case, i. e., (a) the taxes were those of the underliers, not of the debtor; (b) the trustees of the New Haven were not, as such, trustees of the underliers; (c) the reorganization court could hold off the tax gatherers and thus payment was not immediately necessary to continued operation of the underliers' properties; and (d) the underliers admittedly were operating at a loss and their property was of no value to the New Haven, with the result that the payment of their taxes by the New Haven's trustees diverted funds to the underliers' account to the prejudice of the creditors of the debtor and no attempt was made to justify the payment of the underliers' taxes as an allowance for use and occupation. Nevertheless, the Circuit Court of Appeals for the Second Circuit held that the New Haven's trustees were agents of the court within the meaning of

Sec. 124a and as such were subject to all state and local taxes applicable to the business conducted by them, including the underliers' taxes, so long as they operated the underliers' properties.

Thus, in all essential respects, the situation in this and in the *Webster & Atlas* case are the same. Yet opposite results were reached by the Circuit Courts.

It may be thought or asserted that the *Webster & Atlas* case can be distinguished from this case on the ground that the New Haven was in reorganization under Section 77 of the Bankruptcy Act relating to railroad reorganizations, and the continued operation of the underliers' properties by the New Haven trustees was required under subsection (c) (6) thereof, which provides:

> "(6) If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee to continue operation on or for the account of the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of the Interstate Commerce Act as amended."

However, this distinction relates only to the compelling reason for the continued operation of the underliers' properties. In the New Haven reorganization such continued operation was required by appropriate orders of the court under Section 77(c) (6) of the Bankruptcy Act which authorizes the entry of such an order where

separate operation would be impracticable and contrary to the public interest. In the instant proceedings, operation of the underliers' properties, in conjunction with the debtor's properties, as a unified system is continued under the practical compulsion that separate operation of the underliers' properties is impossible and, even if possible, would be impracticable and unsatisfactory to the public and municipal and state authorities (R. 55), although there is no applicable provision of the Bankruptcy Act authorizing the court to enforce, by its order, this practical necessity of unified operation.

Whatever the reason for the operation of the underliers' properties by the debtor's trustees, the point is that in the New Haven case the court held that under Sec. 124a the trustees must pay the underliers' taxes while operation of the properties continues, and in the Pittsburgh Railways case the court held they may not. The Circuit Court of Appeals for the Second Circuit in the *Webster & Atlas* case clearly points out that it is the continued operation which requires the payment of the taxes irrespective of the reason for that continued operation, saying:

> "It is contended, however, that both the taxes and the interest are 'operating expenses,' as the Massachusetts statute provides. But it is not necessary to pass on whether either type of payment is an operating expense, nor need we decide whether § 77, sub. c (6), in and of itself, requires the lessee to pay such expenses not indispensable to the continuance of railroad operations. Whatever the answer to these perplexing questions, federal statutes [i. e., Sec. 124a and Sec. 124—insert ours] impose upon the New Haven trustees a direct duty to meet both the tax and the interest charges." (P. 219)

2. In holding that the trustees of the debtor may not make payment of the underliers' taxes which became due and payable, or which accrued, after the approval of the debtor's original petition for reorganization, the Circuit Court of Appeals decided important questions of Federal law which have not been, but should be, settled by this court.

(a) THE DECISION OF THE COURT BELOW RAISES AN IMPORTANT QUESTION WITH RESPECT TO THE EXTENT OF THE DUTY OF TRUSTEES APPOINTED UNDER THE BANKRUPTCY ACT TO PAY TAXES ASSESSED AGAINST THE BUSINESS OPERATED BY THEM.

In all cases decided by this court and by the lower Federal courts relating to the payment of taxes by trustees or receivers, it has been held that it is their duty to pay all taxes applicable to the business conducted, as if such business were conducted by an individual or corporation; and such taxes have been accorded priority whether or not they are a lien upon the property of the debtor. *Michigan v. Michigan Trust Co.*, 286 U. S. 334, 76 L. Ed. 1136; *Boteler v. Ingels*, 308 U. S. 57, 84 L. Ed. 20; *Coy v. Title Guarantee & Trust Co.*, 220 Fed. 90; *Bear River Paper & Bag Co. v. City of Petoskey et al.*, 241 Fed. 53; *MacGregor v. Johnson-Cowdin-Emmerich, Inc.*, 39 Fed. (2d) 574; *Hardee et al. v. American Security & Trust Co.*, 77 Fed. (2d) 382. However, in all of these cases the taxes in question were the taxes of the debtor or bankrupt corporation itself. In no case has this court decided whether this rule should not be applied as well to taxes levied against underliers so long as the business of such underliers is being operated by the debtor's trustees in conjunction with the debtor's business.

In the present case, the street railway properties used and operated by the trustees have been operated since 1902 as a unified system, and all of the revenues therefrom have been kept in a single fund without at-

tempting to account for the revenues or earnings of the various companies comprising the system. There is no dependable basis for allocating revenues. This could be determined only by operating each underlier separately, which is a physical impossibility. The properties operated in the unified system consist almost entirely of the properties of the underliers, and the funds in the hands of the trustees represent, for all practical purposes, the earnings of the trustees from the use and operation of the underliers' properties. It is expected that the system will be reorganized as a unit and that there will not be any great amount of abandonment of properties of underlying companies. Under such circumstances, the District Court held that the rule laid down in the above authorities should be applied to this case, thus requiring the trustees to pay out of the earnings of the unified system, all taxes of the underliers incurred as a result of the operation of their properties by the trustees pursuant to the order of the District Court entered June 14, 1938. The Circuit Court of Appeals held otherwise, refusing to permit payment of the underliers' taxes on the ground that such payments could not be justified either as tax obligations of the debtor itself, or, in the absence of a precise ascertainment of the revenues derived from or fair value of each separate underlier's property (an admittedly impossible task), as payments on account of use and occupation of the underliers' properties.

It is submitted that the decision of the District Court was correct and that the Circuit Court of Appeals erred in reversing that decision. Having taken possession of the underliers' properties, the trustees should be required to take them *cum onere,* and the taxes here in question arising as a result of the operation of the properties of the underliers should be held as much a part of the trustees' expenses as current upkeep. As stated

by the special master appointed by the District Court to report upon the trustees' petition with respect to the payment of the underliers' taxes:

> "It can hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated." (R. 87, 88)

Taxes are intensely practical. In substance, all of the properties in the possession of the trustees are in reorganization and must be given the same consideration as the properties of the debtor for the purpose of working out a reorganization, for which reason it is necessary that all taxes be paid.

Whether the well established principle that a receiver or trustee is under a duty to pay all taxes accruing as a result of the continued operation of the debtor's business shall be applied to taxes of underliers whose business is also operated by such trustees, is an important question as to the duties of trustees appointed under the Bankruptcy Act which has never been, but should be, determined by this court.

(b) THE DECISION OF THE COURT BELOW RAISES AN IMPORTANT QUESTION AS TO THE INTERPRETATION OF SEC. 124a.

Sec. 124a directs that any trustee appointed by any United States court who is authorized by said court to conduct any business shall be subject to all state and local taxes applicable to such business. In the *Webster*

& Atlas case, *supra,* it was held that under this Act, so long as the trustees of the debtor operate the underliers' properties pursuant to court order, they must pay the taxes of such underliers.

By order of the District Court, entered June 14, 1938, the trustees of Pittsburgh Railways Company were authorized, *inter alia,* to "* * * operate * * * the property and estate in possession of and/or owned by the debtor." The trustees are operating the business of the underliers under authority of this order. Nevertheless, the court below, without any reference to Sec. 124a, the applicability of which was urged upon it, held that the trustees should not pay state taxes of the underliers despite ample funds in the trustees' hands derived largely from the operation of the business of the underliers.

The effect of the Circuit Court's decision is to confine the application of Sec. 124a to taxes assessed in respect of the business of the particular debtor corporation although the order of court appointing the trustees may authorize or direct such trustees to continue the operation of the business of other corporations previously operated by the debtor under lease or other operating agreement, and has the effect of exempting the trustees from the payment of any Federal, state or local taxes assessed in respect of the business of such other corporations, the business of which other corporations has been operated by the debtor, in conjunction with its own, as a unified transportation system for over thirty years. The differing views of the Circuit Court of Appeals for the Second and Third Circuits raise an important question as to the interpretation of Sec. 124a which has not been, but should be, determined by the decision of this court.

(c) THE DECISION OF THE COURT BELOW LIMITING, AS IT DOES, THE EFFECT OF SEC. 124a RAISES SERIOUS CONSTITUTIONAL QUESTIONS WHICH SHOULD BE DECIDED BY THIS COURT.

The trustees have retained the properties of the underliers for more than two years without taking any steps to affirm or disaffirm the leases and operating agreements. In fact the trustees expect that any reorganization effected will be a reorganization of the system as a unit with very little abandonment of properties. It is essential to any reorganization that most, if not all, properties of the underliers be continued in operation as a unified system. The properties of the debtor are negligible in relation to the entire system, and funds in the hands of the trustees, which increased from $230,260.00 at the date of the debtor's original petition to $1,537,247.46 at the date of filing the trustees' petition for instructions as to payment of taxes, are derived almost entirely from the operation of the underliers' properties. Except to the extent that these funds are used for the payment of taxes and other operating and administrative expenses, it is apparent that, since they represent chiefly the revenues of underliers' properties, they are subject to the prior claims of the underliers either in payment of rental under the leases and operating agreements, if affirmed, or for use and occupation, if rejected. As said *In re Schulte Retail Stores Corporation,* 22 Fed. Supp. 612, 615:

> "* * * If the lease were affirmed, the liability would be considered as one for rent; if the lease were rejected, the liability would be for use and occupancy, viz., the reasonable value of the use of the premises which, in turn, would probably be the rent specified in the lease. *Irrespective of the legal characteristics of the liability, it would be recognized as an expense of reorganization and, as such,*

> *it would enjoy priority over claims that accrued prior to the inception of these proceedings.*" (Italics ours)

In such a case, where the debtor's trustees continue to retain possession of and to operate the underliers' properties and to collect and receive the income and revenues thereof, if Sec. 124a be construed, in the light of the power of the trustees to retain possession of leased property until rejected by them, as requiring application of these revenues to the payment of the debtor's taxes but not to the payment of the taxes of the underliers whose properties are retained in possession of the debtor's trustees and operated by them to the benefit of the debtor's creditors, and which taxes of the underliers accrue as the result of such continued operation of their properties by the debtor's trustees, there is a serious question as to whether Sec. 124a, as so construed, does not contravene the Fifth Amendment to the Constitution of the United States which forbids Congress to deprive any person of life, liberty or property without due process of law or to take private property for public use without just compensation.

This court has held that in order that legislation shall not offend against the Fifth Amendment it is necessary that

> "the law shall not be unreasonable, arbitrary or capricious, and that the means selected shall have a real and substantial relation to the object sought to be obtained." *Nebbia v. New York,* 291 U. S. 502, 525; *Railroad Retirement Board v. Alton R. Co.,* 295 U. S. 330, 348.

The effect of the decision of the court below is that the properties of the underliers can be retained by the trustees and operated by them for the benefit of the

unified system, including other creditors of the debtor corporation, without any corresponding duty being imposed upon the trustees under Section 124a to pay the taxes of the underliers accruing as a result of such continued operation of their properties. It is submitted that this decision of the court below raises a serious question whether the Acts referred to, as so construed, are not unreasonable, arbitrary and capricious and deprive the underliers of their properties without due process of law.

Conclusion.

Because of the conflict existing between the decision of the court below in this case and the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Webster & Atlas National Bank of Boston v. Palmer et al.*, 111 Fed. (2d) 215, and because the decision of the court below raises important questions of Federal law as to the application, interpretation and constitutionality of Sec. 124a, which questions have never been, but should be, passed upon by this court, it is respectfully submitted that this petition for writs of certiorari should be granted.

PHILIP A. FLEGER,
W. A. SEIFERT,
Attorneys for Philadelphia Company and Certain Underliers, Petitioners.

We, the undersigned, join in and adopt the foregoing Petition and Brief in behalf of the Citizens Traction Company, Penn Street Railway Company and The

Suburban Rapid Transit Street Railway Company, underliers of the Pittsburgh Railways Company.

LEE C. BEATTY,
RICHARD W. AHLERS,
Attorneys for said Underliers.

I, the undersigned, join in and adopt the foregoing Petition and Brief in behalf of the Allegheny Traction Company and Millvale, Etna & Sharpsburg Street Railway Company, underliers of the Pittsburgh Railways Company.

HILL BURGWIN,
Attorney for said Underliers.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NOS. 242 AND 243.

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRADLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

BRIEF FOR PETITIONERS.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

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INDEX.

Cases Cited.

Statute Cited.

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BRIEF FOR PETITIONERS.

I.

OPINIONS BELOW.

The opinion of the District Court (McVicar, J.) has not yet been officially reported; it appears at pages 78 to 83 of the record, fols. 107 to 113. The opinion of the Circuit Court of Appeals (Maris, C.J.) is reported in 111 Fed. (2d) 932, and will be found at pages 104 to 110 of the record, fols. 147 to 153.

II.

JURISDICTION.

The Circuit Court of Appeals entered its orders on April 30, 1940 (R. 110; fols. 154, 155). On June 12, 1940 said orders were vacated (R. 111, 112; fols. 156, 157), and amended orders were entered (R. 112, 113; fols. 158,

159). No petition for rehearing was filed. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, Chap. 229, § 1, 28 U.S.C.A. § 347, since this is a cause on which final orders of a Circuit Court of Appeals have been entered. The petition for writs of certiorari was filed on July 15, 1940, and the writs were granted October 14, 1940 (R. 115).

III.

STATEMENT OF THE CASE.

Since 1902 Pittsburgh Railways Company (hereinafter sometimes referred to as the "debtor") has been in possession of and has occupied, used and held properties of approximately 55 street railway companies (hereinafter referred to as "underliers") which properties in conjunction with its own properties, the debtor has operated as a unified street railway transportation system in and about the City of Pittsburgh, Pennsylvania, the system being known as the Pittsburgh Railways System (R. 6, 7, 41, 62). The underliers' properties were in possession of the debtor under certain leases and operating agreements which require the debtor to pay expenses of operation and ordinary maintenance and all taxes of the underliers (R. 7).

The Pittsburgh Railways System consists of approximately 560 miles of track, incline plane properties, cars and buildings used primarily for the housing of cars. The debtor itself owns 28 miles of track, cars and other miscellaneous property (R. 79). The debtor has always paid, directly, the expenses of operation and ordinary maintenance and all taxes of the underliers. None of such payments have been made by the underliers (R. 7).

On May 10, 1938, the debtor filed a voluntary petition to effect a plan of reorganization under the provisions of Section 77B of the Bankruptcy Act, and on the same day the court approved the petition as properly filed and continued the debtor in possession with authority to operate its business (R. 6). By order entered June 14, 1938, the court appointed trustees of the debtor and its subsidiary, Pittsburgh Motor Coach Company, and authorized the trustees, *inter alia,* to

> "preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the debtor, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues, and profits of said property and estate; * * * and to pay all taxes and assessments due or to become due upon the property in possession and/or owned by the debtor." (R. 6).

Pursuant to their authority the trustees have since their appointment and qualification been operating the business of both debtor and the subsidiary, using in their operation the properties of the underliers (R. 45). However, the trustees have neither affirmed nor disaffirmed the leases and operating agreements between the debtor and its underliers (R. 62).

On March 10, 1939, the trustees of the debtor filed a petition with the District Court praying for instructions with respect to the payment of taxes of the underliers which became due and payable after the approval of the debtor's original petition (May 10, 1938), together with certain other taxes of the debtor and its subsidiary not material herein (R. 6-20). The taxes of the underliers

concerning which the trustees sought instructions are set forth below.* The trustees' petition averred that at the date of filing the original petition, the cash on hand was $230,260.00, and on March 8, 1939, was $1,537,247.46, the latter amount being sufficient to pay all taxes as to which instructions were requested by the trustees (R. 12). None of the underliers had funds with which to pay any of the taxes assessed against them (R. 13).

The trustees' petition was referred to a special master for hearing and a report thereon (R. 21). At the hearing objections to the payment of the taxes of the underliers were filed by the Tort Creditors' Committee of the debtor (R. 21, 22). Mr. Fitzgerald, one of the trustees who has been in active charge of the operation of the Pittsburgh Railways System since 1924, testified at the hearing that (a) since it was created in 1902 there has been absolutely no effort to account for revenues and operating expenses of individual underliers; (b) to attempt to account for revenues and operating expenses of individual underliers would be tremendously expensive, and the results would not furnish a dependable basis for allocating revenues; (c) the only way in

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*Unpaid balances of Federal income taxes for the year 1937, payments due June 15, September 15, and December 15, 1938 ..... $ 97,412.14

Federal income taxes for the year 1937, withheld at source in respect to interest upon obligations of underliers, payment due June 15, 1938 ..... 6,850.01

Pennsylvania corporate net income taxes for the year 1937, payment due May 15, 1938 ..... 27,639.59

Federal income taxes for the year 1938 ..... 50,501.26

Federal income taxes for the year 1938, withheld at source with respect to interest upon obligations of underliers 2,668.08

Pennsylvania corporate net income taxes for the year 1938 .... 18,335.72

Pennsylvania capital stock taxes for the year 1938 ..... 64,294.57

Pennsylvania corporate loans taxes for the year 1938 in respect to interest upon the obligations of underliers 17,502.56

Total $285,203.93

which net earnings of each underlier could be determined would be to operate each individually, such individual operation being physically impossible and unsatisfactory to the public and to municipal and state authorities; and (d) at present he knows of no method of determining what relative rentals should be paid to the various underlying companies whose properties have been utilized by the debtor or its trustees since May 10, 1938 (R. 40-43). Mr. George, one of the trustees charged with the duty of preparing a plan of reorganization, testified that (a) he believes there will not be a great amount of abandonment of properties of the underliers in the reorganization; (b) he did not consider it practicable for the trustees to say what properties of the underliers will or will not be embraced in the contemplated plan of reorganization; and (c) the properties of the underliers whose taxes were being considered are presently being operated by the trustees (R. 45-47).

The special master filed a report recommending, *inter alia,* that the taxes of the underliers should not be paid by the trustees (R. 67, 68). Exceptions were filed to the special master's report by Philadelphia Company (petitioner herein and principal creditor of and owner of all the capital stock of the debtor), and by certain underliers listed below,* also petitioners herein (R. 72-

* Allegheny, Bellevue and Perrysville Railway Company; The Allenport and Roscoe Electric Street Railway Company; Ben Avon and Emsworth Street Railway Company; Bon-Air Street Railway Company; Cedar Avenue Street Railway Company; East McKeesport Street Railway Company; Glenwood and Dravosburg Electric Street Railway Company; The McKeesport and Reynoldton Passenger Railway Company; Mt. Washington Street Railway Company; Mt. Washington Tunnel Company; Pittsburgh, Allegheny, and Manchester Passenger Railway Company; The Pittsburgh, Allegheny and Manchester Traction Company; Pittsburgh and Charleroi Street Railway Company; Pittsburgh and West End Railway Company; Pittsburgh, Canonsburg and Washington Railway Company; Pittsburgh, Crafton and Mansfield Street Railway Company; Pittsburgh, Neville Island and Coraopolis Railway

78). An argument on the exceptions of your petitioners herein was held before the District Court and, subsequent thereto, counsel for the trustees filed a statement with the District Court recommending the payment of all taxes of the underliers, except Federal income taxes in so far as such income taxes were produced by payments made to the underliers by Philadelphia Company in discharge of its obligations as guarantor of the underliers' lease covenants and except Pennsylvania corporate net income taxes unless and until the liability of the underliers for such taxes should be determined (R. 93-101).

The District Court entered its opinion and order holding and directing that the underliers' taxes be paid to the extent recommended by counsel for the trustees (R. 78-86). From said order of the District Court, in so far as it directed payment of the underliers' taxes, the Tort Creditors' Committee and the City of Pittsburgh appealed to the Circuit Court of Appeals for the Third Circuit (R. 86, 87). The appeals were heard together, and in its opinion filed April 30, 1940, the Circuit Court of Appeals reversed the District Court (R. 104-110). The orders of the Circuit Court entered April 30, 1940 (R. 110) were vacated and amended orders entered June

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Company; Pittsburgh Union Passenger Railway Company; Second Avenue Passenger Railway Company; Second Avenue Traction Company; The Second Avenue Traction Company; Superior Avenue and Shady Avenue Street Railway Company; United Traction Company of Pittsburgh; Washington and Canonsburg Railway Company; West End Traction Company; West Liberty and Suburban Street Railway Company; West Shore Electric Street Railway Company; Consolidated Traction Company; Ardmore Street Railway Company; Central Passenger Railway Company; The Central Traction Company; Fort Pitt Traction Company; The Pittsburgh Traction Company; The Duquesne Traction Company; The Duquesne Street Railway Company; Federal Street and Pleasant Valley Passenger Railway Company; The Morningside Electric Street Railway Company; Seventeenth Street Incline Plane Company.

12, 1940 (R. 111-114), in which it was directed that the order of the District Court be reversed in so far as it directed the payment of taxes involved in the appeals. Petitions for writs of certiorari to review the judgments of the Circuit Court were filed on July 15, 1940, and writs of certiorari were granted October 14, 1940 (R. 115).

IV.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

1. In reversing the order of the District Court.

2. In holding that the taxes of the underliers which became due and payable after the approval of the debtor's original petition should not be paid by the trustees of the debtor.

3. In holding that the taxes of the underliers which accrued after the approval of the debtor's original petition should not be paid by the trustees of the debtor.

4. In requiring payment, in violation of the Fifth Amendment to the Constitution of the United States, of the debtor's taxes out of funds in the possession of the trustees derived largely from the operation of the underliers' properties while forbidding any payment of the underliers' taxes from those funds.

5. In holding that the court must first determine the property of the underliers which is being used, the extent of its use and the net earnings being derived from it or its value before any payment to the underliers on account of use and occupation can be permitted.

6. In holding that the only obligation of the debtor or of the trustees to pay taxes of the underliers is by virtue of covenants in the leases and operating agree-

ments under which the debtor was in possession of the properties of the underliers.

7. In failing to treat the taxes of underliers as operating expenses entitled to payment as expenses of administration.

8. By failing to give proper effect to the Act of June 18, 1934, 48 Stat. 993 (28 U.S.C.A., Sec. 124a).

V.

SUMMARY OF ARGUMENT.

The Act of June 18, 1934, 48 Stat. 993 (28 U.S.C.A. Sec. 124a) directs that any trustee appointed by any United States court, who is authorized by said court to conduct any business, or who does conduct any business, shall be subject to all state and local taxes applicable to such business. The trustees of the debtor are appointees of a United States court and as such are conducting the business of the underliers. Therefore, under the provisions of Sec. 124a they should be required to pay all state and local taxes applicable to the underliers' business. Furthermore, if the Act of June 18, 1934 be narrowly confined to taxes of the debtor itself regardless of the fact that the trustees are also operating the underliers' business, it would be arbitrary, capricious and unreasonable and would violate the Fifth Amendment to the Constitution.

It is a well established general principle that it is the duty of trustees or receivers to pay all taxes, including federal taxes, applicable to the business conducted by them as if such business were conducted by an individual or corporation; and such taxes have been accorded priority whether or not they are a lien upon the property of the debtor. This principle, although announced in cases where the taxes in question were the

taxes of the debtor or bankrupt itself, is equally applicable to taxes levied against underliers so long as their business is being operated by the debtor's trustees. No case has ever required that this principle be narrowly confined to taxes of the debtor itself, and the reasons underlying this principle make it applicable to the underliers' taxes.

All taxes which accrued or became due and payable subsequent to the filing of the debtor's original petition should be paid by the trustees. No technical distinctions should be made on the basis of the date of accrual of the taxes.

Payment of the taxes of the underliers should not be dependent upon separate ascertainment of the net revenue derived from the use of the properties of the respective underliers. The taxes in question should be paid as part of the operation expenses of the trustees. They are not payable solely by virtue of the provisions of the operating agreements and leases. Our position is that the trustees have the duty, independent of any contract, to pay the taxes accrued on the business of the underliers while that business is operated by the trustees. We are not concerned with the trustees' duty to make payments to the underliers under the leases and operating agreements but with the trustees' duty to pay taxes to the sovereign assessing those taxes in respect of business conducted by the trustees.

Even if the only obligation upon the trustees to pay the taxes in question were derived from the leases and operating agreements, the respondents have no cause for complaint. The funds in the hands of the trustees available for the payment of the underliers' taxes are derived almost entirely from the operation of the underliers' business and property, and therefore the underliers have a prior claim upon these funds, either as rent

payments, if the leases and operating agreements be affirmed, or for use and occupation, if rejected. For that reason, if the payment of underliers' taxes were to result in preferences, such preferences would be preferences between the underliers themselves and not preferences of the underliers over any other creditors.

Furthermore, even on the respondent's erroneous assumption that payment of taxes are justified only as allowances for use and occupation, orderly administration of the estate requires that taxes be paid by the trustees as they fall due. The trustees may be completely protected by an order giving the trustees a prior lien on the property of each underlier, in the event of the rejection of the lease of that underlier, to the extent of the excess of the taxes paid on such property over a reasonable allowance, if any, for use and occupation.

VI.

ARGUMENT.

A. The Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. Sec. 124a) Requires the Trustees to Pay All State Taxes Lawfully Assessed Against the Underliers.

The Act of June 18, 1934, 48 Stat. 993 (28 U.S.C.A. Sec. 124a) provides as follows:

> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after the enactment of this Act, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: *Provided, however,* That nothing in this section contained shall be construed to prohibit or prejudice the collection

> **of any such taxes which accrued prior to the approval of this Act, in the event that the United States court having final jurisdiction of the subject matter under existing law should adjudge and decide that the imposition of such taxes was a valid exercise of the taxing power by the State or States, or by the civil subdivisons of the State or States imposing the same."**

By order of the District Court, entered June 14, 1938, the trustees of Pittsburgh Railways Company were authorized, *inter alia*, to "* * * operate * * * the property and assets in possession of and/or owned by the debtor." (R. 6) The trustees are operating the business of the underliers under authority of this order. Nevertheless, the court below, without any reference to Sec. 124a, the applicability of which was urged upon it, held that the trustees should not pay state taxes of the underliers despite ample funds in the trustees' hands derived largely from the operation of the business of the underliers.

The effect of the Circuit Court's decision is to confine the application of Sec. 124a to taxes assessed in respect of the business of the particular debtor corporation although the order of court appointing the trustees may authorize or direct such trustees to continue the operation of the business of other corporations previously operated by the debtor under lease or other operating agreement in conjunction with its own business as a unit, and has the effect of exempting the trustees from the payment of any taxes assessed in respect of the business of such other corporations. Such a construction of Sec. 124a is too narrow.

The Act requires only that the taxes in question be taxes applicable to a business being conducted by trustees appointed by a United States court. Those condi-

tions being met, the taxes must be paid. The present case falls squarely within the boundaries of this Act.

The trustees were appointed by a United States court, and as such appointees are operating the business of the various underliers. Pursuant to certain leases and operating agreements, Pittsburgh Railways Company has, since 1902, been in possession of and has used and operated the properties and franchises of the underliers in conjunction with its own as a unified street railway transportation system (R. 6, 7, 41, 45, 62). Pursuant to the order of court of June 14, 1938, referred to above, the trustees have continued the operation of the business of the debtor and the underliers (R. 45). They have operated the properties and have used and enjoyed the rights, privileges and franchises (except the bare franchise to be a corporation) of each of the underliers. There is no problem here as to whether one corporation should be liable for the obligations of another. The question of maintaining separate corporate entities is not involved. The trustees are as fully possessed of the properties of the underliers as of the property of the debtor. The underliers have no other business and after the trustees of the debtor took possession of their properties the underliers became a mere corporate shell with no assets to use in operating any business whatsoever and with no opportunity to operate a business. The trustees are not possessed of or exercising the franchise to be a corporation of either the debtor or the underliers. The trustees have not affirmed or rejected the leases and operating agreements (R. 62). Accordingly, their operation of the properties of the underliers has not been as lessees or by virtue of any other contract, but solely as agents of the District Court under authority of the aforesaid order of court. It cannot be doubted that, as such, they are actually operating the business of the underlying street railway companies as fully as they are operating the business of the debtor itself. The under-

liers, in fact, are not presently in a position to operate their own business (R. 66). They have no funds, no operating personnel and no rolling stock. As stated by the Special Master appointed by the District Court in this proceeding:

> "It is the duty of a common carrier to furnish and operate 'a reasonably sufficient number of safe facilities, and run and operate the same with such motive power as may reasonably be required, in the transportation of all such passengers or property as may seek, or be offered to it, for such transportation * * *': Pennsylvania Act of May 28, 1937 P. L. 1053, Section 403, Purd. Pa. Digest, Title 66 Section 1173. This duty of the underlying companies which own the tracks and franchises has been performed by Pittsburgh Railways Company or its receivers or trustees since 1902. The underlying owner companies are not presently prepared to resume the performance of their duty to the public. Even if they had the necessary capital, cars and personnel, their several properties have for a generation been operated as a unit and by force of circumstances the operation of many of them has become dependent upon the operation of others of them. It can hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated." (R. 65, 66)

It also follows from what has been said that the taxes in question are "applicable to such business" (*i. e.*

the business operated by the trustees). The taxes in question come into existence solely by reason of the operation of the business operated by the trustees and depend upon the continuance of that business for payment. Furthermore, the non-payment of these taxes, by reason of the imposition of onerous penalties and interest and the possibility of distraint proceedings by the taxing authorities, may hinder or obstruct the operation of the business operated by the trustees. And finally, the effect of non-payment of the taxes will be to lessen the value of the property available for inclusion in a plan of reorganization. Since the whole purpose of the bankruptcy proceedings is to foster the preparation of a plan of reorganization, any tax the non-payment of which tends to thwart that purpose should be held to be "applicable to" the business conducted by the trustees.

The trustees are appointees of a Federal Court who, subsequent to their appointment and qualification, have been operating the business of the underliers. They should be required, under the provisions of Sec. 124a, to pay the state taxes applicable to such business.

A further reason for construing Sec. 124a to require the payment of the taxes in question is that, unless the statute be so construed, it is unconstitutional as depriving the underliers of their property without due process of law in violation of the Fifth Amendment of the Constitution of the United States. It is elementary that an unconstitutional construction will be avoided wherever possible. The effect of Sec. 124a must be viewed in the light of a case, such as the present, in which the trustees are operating not only the property of a debtor, but the property of underliers as well. Congress must have contemplated that the trustees would take a "breathing spell" within which to determine whether to adopt or reject the leases of

the underliers. *In re Chase Commissary Corporation,* 11 Fed. Supp. 288; *Palmer v. Palmer,* 104 Fed. (2d) 161. If, during this "breathing spell", Sec. 124a be construed to permit the imposition of the liens of taxes, penalties and interest upon the properties of the underliers, and the consequent deprivation of the property of the underliers, its operation is arbitrary and discriminatory and not related to the legislative purpose, namely, the orderly and equitable administration of insolvent estates, and it would therefore, if so construed, be unconstitutional. *Nebbia v. People of State of New York,* 291 U. S. 502, 537; 78 L. Ed. 940. The underliers are entitled to have their property preserved while it remains in the hands of the trustees. If the underliers' property is returned to them, subject to the burdens, not only of taxes, but of penalties and interest, and if at the same time the property of the debtor itself is preserved intact, it is apparent that Sec. 124a, in its practical operation, is arbitrary, capricious and discriminatory.

B. As a Matter of General Law, the Federal as Well as the State and Local Taxes Assessed Against the Underliers Should Be Paid by the Trustees.

In all cases decided by this Court and by the lower Federal Courts relating to the payment of taxes by trustees or receivers, it has been held, as a general principle of law, that it is their duty to pay all taxes applicable to the business conducted by them as if such business were conducted by an individual or a corporation; and such taxes have been accorded priority, as expenses of the administration, whether or not they are liens upon the property of the debtor. *Michigan v. Michigan Trust Co.,* 286 U. S. 334, 76 L. Ed. 1136; *Boteler v. Ingels,* 308 U. S. 57, 84 L. Ed. 20; *Coy v. Title Guarantee & Trust Co.,* 220 Fed. 90; *Bear River Paper & Bag*

Co. v. City of Petoskey et al., 241 Fed. 53; *MacGregor v. Johnson-Cowdin-Emmerich, Inc.*, 39 Fed. (2d) 574; *Hardee et al. v. American Security & Trust Co.*, 77 Fed. (2d) 382. In all of these cases the taxes in question were the taxes of the debtor or bankrupt corporation itself. However, it is submitted that the general principle is applicable to the present case and that the trustees should be required to pay the taxes assessed in respect of the business of the underliers so long as the business of such underliers is being operated by the debtor's trustees in conjunction with the debtor's business.

In *Michigan v. Michigan Trust Co.*, 286 U.S. 334, 76 L. Ed. 1136, it is said:

> "* * * Taxes owing to the Government, whether due at the beginning of a receivership or subsequently accruing, are the price that business has to pay for protection and security."

In *Coy v. Title Guarantee & Trust Co., et al.*, 220 Fed. 90, it is stated:

> "It is too clear for argument that the appointment of a receiv and the taking of property into the hands of the court through its officer does not withdraw it from taxation. It remains subject to assessment and to the payment of all legal taxes thereon while in custodia legis, to the same extent as it was while in the possession of the owner. And whether or not such taxes be a lien or a debt by the laws of the government within whose jurisdiction the property is situated, such taxes are and should be regarded by the courts as a preferred and paramount claim over all other claims, for they are essential to the existence and maintenance of the very government under which the property is acquired and protected.

"'A court', said Cooley on Taxation (3d Ed.) Vol. 2, p. 834, 'having in its charge or under its control a fund or other property upon which taxes are due, will, as the representative of the sovereignty, direct them to be paid without raising any question of the means of enforcement by process, and before all other claims except judicial costs. Thus upon proper application and suitable proof a receiver will be ordered to satisfy a tax assessed against the property in his hands, and a like direction will be made in other cases where funds are held subject to the authority of the court.'"

In *Bear River Paper & Bag Co. et al. v. City of Petoskey et al.*, 241 Fed. 53, it is stated:

"We think it unnecessary to decide the question of lien. These taxes were owing to the state, the county, and the city as the consideration for governmental benefits enjoyed by this property and this business during three years. The property has been in possession of the receivers, and the business has been conducted by them. It is not claimed that any other tax has been assessed in this state against them, or against the property, or against the mortgagor, or mortgagee, or mortgage bondholders. It might have been assessed against the receivers, for C. L. Sec. 3837 (6) says:

"'Personal property mortgaged or pledged shall be deemed the property of the person in possession thereof, and may be assessed to him.'

"It is not claimed that the taxes are unjust or in any way inequitable. Under these conditions, and even if it were to be assumed that the taxes had not become a lien against the property, or that, through the mistake of the assessing officers, no enforceable debt against the receivers had arisen, a due regard for the rightful burdens of all citizens and residents

toward the state government, and a due recognition of benefits received should impel a federal court to direct its receiver to make payment. Such payment, in the absence of a meritorious objection to the tax, we regard as the receiver's clear duty; and so it has been held, in substance, if not specifically. In Re Tyler, 149 U.S. 164, 187, 13 Sup. Ct. 785, 37 L.Ed. 689; Coy v. Title Co. (C.C.A. 9) 220 Fed. 90, 92, 135 C.C.A. 658, L.R.A. 1915E, 211."

The basis for the general rule established by these cases is that taxes should be paid as the consideration for the governmental benefits enjoyed by the property or business in respect of which such taxes are assessed. It is for this reason that the above cases have held that receivers and trustees in possession of and operating a business should be required to pay taxes assessed in respect of that business in preference to other claims.

When the reason for the rule is thus understood, it is clear that the rule itself should be applied as well to taxes levied against the underliers so long as the business of such underliers is being operated by the debtor's trustees.

In the present case, the street railway properties used and operated by the trustees have been operated since 1902 as a unified system, and all of the revenues therefrom have been kept in a single fund without attempting to account for the revenues or earnings of the various companies comprising the system. There is no dependable basis for allocating revenues. This could be determined only by operating each underlier separately, which is a physical impossibility. (R. 40, 41, 42, 43). The properties operated in the unified system consist almost entirely of the properties of the underliers (R. 79), and the funds in the hands of the trustees represent, for

practical purposes, the earnings of the trustees from e use and operation of the underliers' properties. The nds in the hands of the trustees are more than ample pay all the taxes here in question (R. 12). None of the derliers has funds with which to pay any of the taxes sessed against them (R. 13). It is expected that the stem will be reorganized as a unit and that there will t be any great amount of abandonment of the proper- s of underlying companies (R. 45). Under such cir- mstances the District Court held that the rule laid wn in the above authorities should be applied to this se, thus requiring the trustees to pay out of the earn- gs of the unified system, all taxes of the underliers curred as a result of the operation of their properties the trustees pursuant to the order of the District urt entered June 14, 1938 (R. 78-83). The Circuit urt of Appeals held otherwise, refusing to permit pay- ent of the underliers' taxes on the ground that such yments could not be justified either as rent payments , in the absence of a precise ascertainment of the reve- es derived from or fair value of each separate under- r's property (an admittedly impossible task), as pay- ents on account of use and occupation of the under- rs' properties (R. 104-110).

It is submitted that the decision of the District urt was correct and that the Circuit Court of Appeals red in reversing that decision. Having taken posses- on of the underliers' properties, the trustees should be quired to take them *cum onere*, and the taxes here in estion, arising as a result of the operation of the busi- ss of the underliers, should be held as much a part of e trustees' expenses as current upkeep. Operating ex- nses refer to charges for ordinary maintenance and ould include any charges necessary to preserve the operty in question, pending the formulation of a plan reorganization.

As stated by the Special Master appointed by the District Court to report upon the trustees' petition with respect to the payment of the underliers' taxes:

> "It can hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated." (R. 66)

Taxes are intensely practical. In substance, all of the properties in the possession of the trustees are in reorganization and must be given the same consideration as the properties of the debtor for the purpose of working out a reorganization, for which reason it is necessary that all taxes be paid.

As stated by the District Court, after reviewing the above cases:

> "The rule laid down in the above authorities should be applied to taxes levied against the underliers in this case. The system is a unit; it is proposed to reorganize it as a unit; the fund from which the taxes are to be paid arise from this unit; the taxes must be paid ultimately; interest and penalties are accruing by reason of non-payment; the taxes 'are the price that business has to pay for protection and security'; 'taxes are and should be regarded by the courts as a preferred and paramount claim over all other claims.' The same rule should be applied to State and Federal taxes as applies to local taxes. Taxes legally levied against the

underliers and which became due and payable after the approval of the original petition are an administration expense and should be ordered paid, subject to the qualification in the decree filed herewith." (R. 83)

The District Court was correct in treating the development and consummation of a plan of reorganization as its dominant consideration. The whole purpose of the reorganization proceedings, and the purpose of the rule permitting the trustees to retain leased property pending an affirmance or disaffirmance of the underliers' leases, is to facilitate preparation of a plan of reorganization. The court should preserve intact all of the property in its possession as long as there remains any possibility that the property will be used in the consummation of a plan of reorganization. *Continental Illinois Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U.S. 648, 77 L.Ed. 1110. As long as the properties are retained by the trustees there remains the possibility that they will be retained in the plan of reorganization. This possibility justifies, and requires, the payment of the taxes.

C. The Taxes of the Underliers Which Became Payable After Approval of the Debtor's Original Petition Should Be Paid by the Trustees Regardless of the Date of Accrual of Such Taxes.

Of the taxes of the underliers involved in this appeal, in the case of Federal income taxes for the year 1937, the return was required to be filed on March 15, 1938, and one-fourth of the tax shown on the return was required to be paid on March 15, 1938, and the payment of the balance of such tax was required in three equal installments on June 15, September 15, and December 15, 1938; in the case of Pennsylvania corporate net in-

come taxes for the year 1937, the return was required to be filed on April 15, 1938, and one-half of the tax shown on the return was required to be paid on April 15, 1938, and the balance thereof on May 15, 1938. On May 10, 1938, the debtor filed its petition which was prior to the time when the said June, September and December installments of Federal income taxes and the said May installments of Pennsylvania corporate net income taxes became due and payable.

The court below said (R. 107):

> "Even though the taxpayer was given the option to pay these taxes in installments, the taxes were actually due on the dates mentioned (March 15, 1938 and April 15, 1938, insert ours), which were the dates fixed by law for filing the tax returns. The failure of the debtor to pay these taxes was a breach of the leases and operating agreements and the amounts then due became simple contract claims against the debtor, due when the debtor's petition was filed. As to these claims the underliers must take their position with all other general creditors."

The debtor's obligation under the leases and operating agreements was to pay the taxes when payment was due the Federal government, namely, one-fourth of the tax on March 15, 1938 and the balance in three equal installments on June 15, September 15, and December 15, 1938. Therefore, the debtor had not breached its contract and the underliers had no cause of action against the debtor prior to the filing of the debtor's original petition. The liability of the debtor did not ripen until subsequent to the filing of its petition, or, in other words, until the June 15, 1938 installment became due and payable to the Federal government. So long as the debtor's trustees were operating the business of the underliers when these taxes became a liability of such trustees, they should be paid.

D. Payment of the Taxes of the Underliers by the Trustees Should Not Be Dependent Upon a Separate Determination of the Net Income Derived From the Properties of Each Underlier. Payment of the Underliers' Taxes Will Not Result in Objectionable Preferences.

The respondents' position and the decision of the court below are based upon the assumption that the only obligation of the trustees to pay the taxes here in question is a contractual one under the provisions of leases and operating agreements pursuant to which the properties of the underliers were operated by the debtor. On that premise their position is that until the leases and operating agreements are affirmed or disaffirmed, the only obligation of the trustees to the underliers is to pay an amount for use and occupation of their properties measured by the use, extent of its use and the net income therefrom and that, since it is impossible to determine separately the net revenue derived from the operation of each underlier's properties, no allowance can be made, by tax payment or otherwise, in order that there may be no preference of the underliers over other creditors.

This is entirely too narrow a view. It loses sight of the true reason why these taxes should be paid. The trustees themselves state:

> "We do not contend these taxes are payable because the debtor contracted to pay them. While such contracts exist, thus far the Trustees have not affirmed them and may never do so. Whatever might be the effect of affirmance of the operating agreements and leases on the obligation of the Trustees to the underliers, we submit that the obligation of

the Trustees to the taxing authorities is not governed by those contracts or by any action that might be taken by the Trustees with respect to them. Nor do we contend these taxes are payable as compensation for use and occupancy of the underliers' properties by the Trustees." (R. 106, note 3)

As we have stated above, these taxes are payable as part of the consideration for the protection and security afforded by the sovereign imposing the taxes to the business and properties being operated by the trustees. Such are operating expenses of the very highest character. There is no question here involved concerning the underliers' right to receive a return upon their properties. The respondents make their error in viewing this case as if it involved a demand for a payment to the underliers. The underliers do not seek any return for themselves. All they ask is that they be not deprived of their property by the imposition of tax liens.

However, even on the narrow premise assumed by the respondents that the trustees' obligation to pay the underliers' taxes is based upon the leases and operating agreements we cannot accept their conclusions. Mr. George, a co-trustee, testified that all of the properties of the underliers are being used. A study of the authorities in which it is announced that allowances to underliers are dependent upon a separate determination of net revenues from their properties indicates that this principle has application only to cases where the earnings are susceptible of determination with reasonable accuracy. It was a measure used in those particular cases for determining the amount payable to the lessors for the use and occupancy of their properties. *American Brake Shoe & Foundry Co.*, 282 Fed. 523; *Westinghouse Electric & Manufacturing Co. v. Brooklyn Rapid Transit*

Co., 6 Fed. (2d) 547. In *North Kansas City Bridge & Railroad Co. v. Leness*, 82 Fed. (2d) 9, where the receiver actually made payments to the lessor for use and occupancy of the property prior to disaffirming the lease, the court said:

> "Undoubtedly the receiver and the court below continued the unprofitable operation of the line in the hope that times and conditions might so change that a purchaser could be found for it as a going concern, or that the company might in some way be reorganized.
>
> * * * * * *
>
> "The theory of the bondholders' committee that the Bridge Company is entitled to nothing is based on cases all of which involve the rental of extensive railway trackage constituting more or less complete transportation systems of themselves, the separate earnings of which were determinable with reasonable accuracy, and the use of which trackage was shown to have produced nothing for the receiver."

It is submitted that the legal principle advanced by respondents has no application here where the separate earnings of the respective underliers are not susceptible of determination with reasonable accuracy.

The fear of preferences of underliers over other creditors is also without foundation. The funds in the hands of the trustees available for the payment of the underliers' taxes represent, for all practical purposes, the earnings of the trustees from the use and operation of the business and properties of the underliers (R. 65). These funds are subject to the prior claims of the underliers either as rental if the leases and operating agreements should be affirmed, or for use and occupation if rejected. As said in *In Re Schulte Retail Stores Corp.*, 22 Fed. Supp. 612, 615:

"* * * If the lease were affirmed, the liability would be considered as one for rent; if the lease were rejected, the liability would be for use and occupancy, viz., the reasonable value of the use of the premises which, in turn, would probably be the rent specified in the lease. *Irrespective of the legal characteristics of the liability, it would be recognized as an expense of reorganization and, as such, it would enjoy priority over claims that accrued prior to the inception of these proceedings.*" (Italics ours)

If therefore, any perference would result from payment of the underliers' taxes out of these funds, it would be a preference between the underliers themselves and would not injure any of the parties who are objecting to these payments. The underliers themselves have not objected and would be estopped to make any claims by reason thereof.

Finally, and still assuming the respondents' erroneous contention that payments of taxes are justified only as allowances for use and occupation, it does not follow that the payment of taxes should be deferred. Orderly administration of the estate requires that the taxes of underliers be paid as they fall due (thereby avoiding the liens of penalties and interest, and avoiding inconvenience to the taxing authorities) and that the rights of the parties be adjudicated by later proceedings or in the plan of reorganization. The trustees could be completely protected by an order, entered at the time of the payment of the taxes, similar to the order entered in the New York, New Haven & Hartford reorganization, and tacitly approved by this court. *Warren v. Palmer,* 310 U. S. 132, 135, 136; 84 L. Ed. 752. Such an order would provide that, in the event of the rejection of the lease of an underlier, the trustees should be entitled to a prior lien on the property of such an underlier to the

extent of the excess of the taxes paid on such property over a reasonable allowance, if any, for use and occupation.

Such an order would completely protect the trustees. If the lease of a given underlier is adopted, or if its property is included in the plan of reorganization, the trustees cannot complain of having paid the taxes on such property. If a given lease is rejected, the trustees are adequately protected by an order of the type suggested, in the absence of a showing that the value of the property of any given underlier is less than the amount of the taxes to be paid thereon. There has been no such showing in the present case, and in this respect the underliers in the present case are in a much stronger position than are the underliers involved in the Webster & Atlas National Bank case (*Webster & Atlas Nat. Bk. v. Palmer,* 111 Fed. (2d) 215. Certiorari granted October 14, 1940; 120 October Term, 1940, in this Court.)

VII.

Conclusion.

Under Sec. 124a the trustees are required to pay the state and local taxes assessed in respect of the business of the underliers, and upon general principles they should likewise pay the federal taxes of the underliers so long as they continue to operate the business and properties of the underliers in conjunction with the business and properties of the debtor. All taxes which accrued or became due and payable after the approval of the debtor's original petition should be paid. Such payment should not be made to depend upon a separate ascertainment of the net income derived from the properties of each underlier. No objectionable preference will result from such payments. It is respectfully submitted that the judgment of the Circuit Court of Appeals

for the Third Circuit in these proceedings should be reversed and the orders of the District Court affirmed.

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W. A. SEIFERT,
Attorneys for Philadelphia Company and Certain Underliers, Petitioners.

We, the undersigned, join in and adopt the foregoing Brief in behalf of the Citizens Traction Company, Penn Street Railway Company and The Suburban Rapid Transit Street Railway Company, underliers of the Pittsburgh Railways Company.

LEE C. BEATTY,
RICHARD W. AHLERS,
Attorneys for said Underliers.

I, the undersigned, join in and adopt the foregoing Brief in behalf of the Allegheny Traction Company and Millvale, Etna & Sharpsburg Street Railway Company, underliers of the Pittsburgh Railways Company.

HILL BURGWIN,
Attorney for said Underliers.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NOS. 242 AND 243.

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

REPLY BRIEF FOR PETITIONERS.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

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INDEX.

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REPLY BRIEF FOR PETITIONERS.

The respondents, in their brief filed with the Court below, and the Circuit Court of Appeals, in its opinion, misconceived petitioners' contention in this case. It was thought that that misunderstanding would be dispelled by the brief filed by petitioners in this Court. Apparently, however, respondents have continued to misinterpret petitioners' argument. It is with the hope that petitioners' position may be clarified that this reply brief is filed.

Much of respondents' brief is devoted to the argument that the separate corporate entities of the debtor and the various underliers should be strictly maintained. With this contention petitioners do not quarrel. But

respondents' argument is based upon the assumption that petitioners seek to have this Court treat the debtor and underliers as if they were one corporation. This is not so. Petitioners recognize that the underliers are separate and distinct entities to be so treated for all purposes. Neither the debts, obligations, undertakings nor torts of one should be visited upon another. But no such problem is involved. The question presented by this case is—*Shall the trustees pay the taxes of the debtor and each of the underliers?*

The Trustees are three individuals. They are not a corporation. They are not possessed of nor are they exercising the corporate franchise of either the debtor or any of the underliers. The debtor and each underlier has and maintains its separate corporate organization and franchise. Each has its officers and its board of directors. The trustees are not concerned with these, either in the case of the underliers or the debtor. Petitioners do not seek to treat the trustees as a corporation or to substitute them for the corporate entities of the debtor or any of the underliers as petitioners recognize them as separate independent agents appointed by the District Court. How, then, can it be said that any question of the recognition or nonrecognition of separate corporate entities is involved? Yet the problem continues to be *shall the trustees pay the taxes of the underliers as well as of the debtor?*

The trustees, as agents of the District Court, have taken possession of and are operating all the properties of the debtor. As such they have also taken possession of and are operating all the properties of each of the underliers. Their possession of one is no more complete than their possession of the other. If then, it be conceded that they are operating the business of one, how can it be denied they are operating the business of all? *And this is the true crux of the case.* For under the

Act of June 18, 1934,* referred to in petitioners' original brief, as well as under the general rule established by the decisions of this Court therein cited, if the trustees are operating the businesses of the underliers they must pay all taxes applicable to those businesses whether the underliers are one or many separate entities.

Respondents entirely overlook a very important fact. The trustees have not affirmed or rejected the leases and operating agreements which exist between the debtor and the underliers. Had the trustees affirmed those leases and agreements, their position would be that of lessees or operators under contract who, by adoption, had made the leases and agreements as effectively their own as if they were the original parties thereto. On the other hand, if the trustees had rejected those leases and agreements, the estate of the debtor would be liable for breach of contract and for use and occupation by the trustees. But during the trial period, the trustees operate the business and properties of the underliers by virtue of the power vested in them by law as appointees of the Court. Their liability for taxes follows from this fact of operation only and is not based on any contract. The respondents' assumption, that the liability of the trustees for the underliers' taxes in this case is derived from what would be the source of the debtor's liability for such taxes had it continued to operate under the leases and operating agreements, is utterly fallacious. The respondents' entire first point, to wit, that there is no tax liability upon the trustees by virtue of the leases and operating agreements is, therefore, entirely beside the point and is conceded by the petitioners. Indeed, they base their position upon it. Petitioners contend that the trustees are operating the businesses of the underliers by virtue of their ap-

* 48 Stat. 993 (28 U. S. C. A. Sec. 124(a)).

pointment by the District Court, and it follows, under the statute and general law, that they must pay the taxes assessed against such businesses. If and after the trustees affirm or reject the leases and operating agreements, a different problem arises which is not here presented.

Cast aside, then, the contentions of respondents that "separate corporate structures will not be erased" and "taxes assessed against the underliers cannot be paid as advances on use and occupancy".* For clarity of vision, look at the problem from another approach. Start with the statute and the federal decisions. Under the general principle of the cases, buttressed, as to state and local taxes, by the Act of June 18, 1934, the trustees must pay the taxes assessed in respect of the business of the underliers *if* the trustees are conducting their businesses. Are the trustees conducting the business of the underliers? It is submitted there can be no doubt that they are. Read carefully and analyze respondents' argument on this, the real question.** Aside from references to the doctrine of use and occupation allowances under rejected leases, to the doctrine of separate corporate entities and to the fact that there is no tax obligation upon the trustees under the leases and operating agreements, all of which are beside the point, the respondents do no more than assert that the trustees are not operating the underliers' businesses. Respondents advance no reasons from which such a conclusion can be reached. They merely assert it. In fact, sound reasoning and reported judicial thinking support petitioners' position that the trustees are operating the underliers' businesses. As has been previously stated, the trustees, by virtue of the authority vested in them by

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* Respondents' third and fourth points.

** Respondents' second point.

the District Court, are in as full control of and are exercising as complete domination over the businesses of the underliers as they are over that of the debtor. The business of each of the underliers and the purpose of their formation is and was the operation of passenger street railways. These railways are being operated by the trustees who are in possession of all the properties of the underliers. This is the only business the underliers have. Nothing remains in the hands of the underliers except their bare corporate organization, *i. e.*, their officers and boards of directors, and this is equally true of the debtor. In *McCoach v. Minehill & S. H. R. Co.*, 228 U. S. 295, 57 L. Ed. 842, this Court has held that where a railroad leases all of its track and properties to another, it is no longer doing business. Its business is conducted by the lessee. In the case cited the pertinent facts were stated by the Court as follows:

> "Pursuant to this lease the entire railroad and all property connected therewith was turned over to the Reading Company, and since then has been operated by that company, and the Minehill Company has not carried on any business in connection with the operation of it. It has, however, maintained its corporate existence and organization by the annual election of a president and board of managers, and this board has annually elected a secretary and treasurer. It receives annually from the Reading Company the fixed rental called for by the lease; and it receives annually sums of money as interest on its bank deposits, and also maintains a 'contingent fund,' from which it receives annual sums as interest or dividends. And it annually pays the ordinary and necessary expenses of maintaining its office and keeping up the activities of its corporate existence, including the payment of salaries to its officers and clerks. It keeps and maintains at its office, stock

books for the transfer of its capital stock, and this stock is bought and sold upon the market. The annual income from the contingent fund appears to be about $24,000, its annual payments for state taxes about as much, and its expenditures for corporate maintenance about $5,000.

"The corporation tax law (act of August 5, 1909, § 38, 36 Stat. at L. chap. 6, pp. 11, 112-117, U. S. Comp. Stat. Supp. 1911, pp. 741, 946-951) provides:

" 'That every corporation * * * organized for profit and having a capital stock represented by shares * * * and engaged in business in any state * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above $5,000, received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations * * * subject to the tax hereby imposed.' " (P. 844)

The Court held as follows:

"From the facts as stated above it is entirely clear that the Minehill Company was not, during the years of 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading Company. If that lease had been made without authorization of law, it may be that for some purposes, and possibly for the present purpose, the lessee might be deemed in law the agent of the lessor; or, at least, the lessor held estopped to deny such agency. But the lease was made by the express

> authority of the state that created the Minehill Company, conferred upon it its franchise, and imposed upon it the correlative public duties. The effect of this legislation and of the lease made thereunder was to constitute the Reading Company the public agent for the operation of the railroad, and to prevent the Minehill Company from carrying on business in respect of the maintenance and operation of the railroad so long as the lease shall continue. And it is the Reading Company, and not the Minehill Company that is 'doing business' as a railroad company upon the lines covered by the lease, and is taxable because of it." (P. 846)

The leases and operating agreements under which the debtor operated the business and properties and franchises of the underliers were likewise authorized by Pennsylvania statutes. See Act of 1895, P. L. 63, Sec. 1, 67 Purdons, Sec. 1279; and Act of 1895, P. L. 64, Sec. 1, 15 Purdons, Secs. 1894 and 1895, which are set out in the appendix hereto.

Therefore, prior to the filing of its original petition, the debtor was operating the businesses of the underliers. Equally, the trustees are now operating those businesses. It follows, under the Act of June 18, 1934, and accepted general legal principles, that the trustees must pay the taxes assessed in respect of the underliers' businesses so long as operated by the trustees.

Respondents cite the committee report on the Act to the effect that its purpose is to subject *businesses conducted* under federal receivership to taxes the same as if *such businesses* were being conducted by private individuals. On this basis, respondents attempt to confine the application of the governing statute and general rule to taxes that were taxes, as such, of the debtor itself prior to commencement of reorganization proceedings.

What a complete *non sequitur*. It may well be that the *debtor's* obligation to pay underliers' taxes was not a tax obligation. On pages 14 and 15 of respondents' brief, they cite several cases to prove the point that *debtor's* obligation was a contractual not a tax obligation. But clearly it does not follow that the trustees are not bound to pay the taxes. As pointed out by the District Court in its opinion (R. 80), the trustees are, without objection, paying the expenses of maintaining the property of the underliers and real estate taxes assessed thereon to the respondent, the City of Pittsburgh, and other municipalities. If the trustees are now conducting the businesses of the underliers, they are bound by statute and general law to pay the taxes of the underliers. This principle is clearly supported by the decision of this Court in *Warren v. Palmer*, 310 U. S. 132, 84 L. Ed. 1118, in which it was said:

> "This Court has held 'upon principles of general application' that courts having custody of property or a fund have the power 'to require that expenses which have contributed either to the preservation or creation of the fund in its custody shall be paid before a general disposition among those entitled to receive it.' Such a power reposes in any court charged with custody of property. It is an in rem jurisdiction springing from possession of the property which is necessary in order that the court may adequately care for the property." (pp. 1123, 1124)

Sec. 124 (a) (the Act of June 18, 1934) never intended to confine the trustee's obligation to pay taxes to those taxes paid by the debtor as a tax obligation. The purpose is broader. As stated by the committee report quoted by respondents on page 20 of their brief "No good reason is perceived why a receiver should be permitted to operate under such an advantage as

against his competitors not in receivership, and the states and local governments be deprived of this revenue." This reasoning compels payment of all taxes on *all businesses conducted by the trustees*, irrespective of the nature of the debtor's obligation to pay taxes as it existed prior to institution of the reorganization proceedings.

CONCLUSION.

The trustees are operating the businesses of the underliers. It follows. under general principles as announced by federal decisions as to all taxes and under the Act of June 18, 1934, as to state and local taxes, that the trustees must pay the taxes assessed in respect of all businesses conducted by the debtor. Had respondents directed their brief to this issue, the only real issue, petitioners would have rested on their original brief, believing their position to be unassailable. It has been the purpose of this reply brief to clarify the issue. Petitioners respectfully submit that the judgment of the Circuit Court of Appeals for the Third Circuit should be reversed and the order of the District Court affirmed.

Respectfully submitted,

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Attorneys for Philadelphia Company and Certain Underliers, Petitioners.

APPENDIX.

The Act of 1895, P. L. 63, Sec. 1, 67 Purdons, Sec. 1279, reads as follows:

"§ 1279. Sale or lease of property and franchises to traction or motor-power companies

"Any street passenger railway company heretofore or which may hereafter be incorporated in this commonwealth, under general or special laws, whose line or lines are not on township or country roads, is hereby authorized to sell or to lease, or to lease and to sell its property and franchises to any traction or motor-power company incorporated under the laws of this commonwealth, not operating a line or lines of railway on township or country roads, upon such terms as shall be agreed upon."

The Act of 1895, P. L. 64, Sec. 1, 15 Purdons, Secs. 1894 and 1895, reads as follows:

"§ 1894. Traction or motor-power companies may sell or lease property and franchises

"Any traction or motor-power company heretofore or hereafter incorporated under the laws of this commonwealth is hereby authorized to sell or to lease, or to lease and to sell its property and franchises, as well those owned as those leased, operated or controlled by it, including so much of any line or lines of passenger railways owned, leased or controlled by it as is located upon street or streets, to any other traction or motor-power company incorporated under the laws of this commonwealth, upon such terms as may be agreed upon.

"§ 1895. May contract for operation of lines

"Such traction or motor-power company may also enter into contracts with other traction or motor-power companies incorporated under the laws of this commonwealth, for the operation of lines of railway and property owned, leased, operated or controlled by it: Provided, That nothing herein contained shall be construed as authorizing any traction or motor-power company to acquire, lease or operate so much of the line of any other motor-power company as occupies any township, borough or county road."

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IN THE

SUPREME COURT OF UNITED STATES

OCTOBER TERM, 1940

NOS. 242 AND 243

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers,
Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH,
Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI

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INDEX

CASES CITED

STATUTE CITED

CONSTITUTION OF THE UNITED STATES

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I.

COUNTER-STATEMENT OF THE CASE

Respondents agree in substance with the Statement of the Case contained in the petition for writs of certiorari under the heading of "Summary Statement of the Matter Involved" (pages 2 to 6) but desire to call to the attention of the court the following information with respect to certain items in the list of taxes involved in the case set forth in the footnote on page 4:

(1) The Federal Income taxes for the year 1937 became

due on March 15, 1938, although payment was permitted in quarter annual installments so that the balance due became payable on June 15, September 15 and December 15, 1938.

(2) The Federal Income taxes for the year 1937 withheld at source became due on March 15, 1938, although payment was not required to be made until June 15, 1938.

(3) The Pennsylvania corporate net income taxes for 1937 became due on April 15, 1938, although payment was not required to be made until May 15, 1938.

II.

COUNTER-STATEMENT OF QUESTIONS INVOLVED

1. Where Trustees of a street railways company in reorganization under Section 77B and Chapter X of the Bankruptcy Act are operating the business of the debtor, using in such operation not only the properties owned by the debtor but also properties belonging to underlying companies of the debtor, which latter properties have prior to the institution of reorganization proceedings been operated by the debtor under leases and operating agreements whereby the debtor has obligated itself to pay all the taxes which the said underlying companies are required to pay, which leases and operating agreements have neither been affirmed nor disaffirmed by said Trustees, should said Trustees be authorized and directed to pay the taxes against the underlying companies which accrued during the pe-

riod of operation of their properties by the debtor in possession and by the said Trustees when it has not been shown that the net revenues from the properties of each of the underlying companies realized during the period of operation by the debtor in possession and by the Trustees are sufficient to pay the taxes of each underlier?

2. Where the debtor street railways company, pursuant to leases and operating agreements whereby it operates the properties of underlying companies, has obligated itself, *inter alia,* to pay all the taxes assessed against the underlying companies, should the Trustees of the debtor in reorganization, who are operating the debtor's business, using in such operation not only the properties owned by the debtor but also those owned by the underlying companies, be directed to pay during the course of the administration in reorganization, before there has been a classification of the creditors of the debtor and before a plan of reorganization has been confirmed, the taxes against the underlying companies which accrued prior to the institution of the reorganization proceedings?

III.

ARGUMENT

The petition for certiorari raises questions with respect to two different groups of taxes, each of which involves different considerations. On the one hand there is a group of taxes of the underliers which accrued and the liability for which became fixed subsequent to May 10, 1938, the date of the filing of the petition for reorganization. On the

other hand there is a group of taxes of the underliers which accrued and the liability for which became fixed prior to the filing of the petition for reorganization although the time for payment had been deferred by permissive federal and state legislation until after the institution of the reorganization proceeding. Because of the different questions of law involved with respect to the payment of the two groups of taxes, the reasons assigned by petitioners for the granting of their petition for writs of certiorari will be discussed separately with respect to each of the two groups.

A.

Taxes which Accrued and the Liability for which Became Fixed Subsequent to the Filing of the Petition for Reorganization.

1. With Respect to this Group of Taxes the Decision of the Court Below Is Not in Conflict with the Decision of the Circuit Court of Appeals for the Second Circuit in Webster & Atlas National Bank of Boston v. Palmer et al., 111 Fed. (2d) 215, Decided April 16, 1940.

It is true that in the instant case the Circuit Court of Appeals held that the trustees of the debtor should not pay the taxes of the underliers whose properties are being used by the trustees under the debtor's leases and operating agreements, whereas in the *Webster & Atlas* case the court directed the trustees of the debtor to pay taxes legally assessed against the debtor's lessors while the trustees were operating the lessors' businesses. However, it is respectfully submitted that the fact situations of the two cases differ so substantially that they presented to the courts entirely different questions.

In the *Webster & Atlas* case, the trustees of the New York, New Haven & Hartford Railroad Company, debtor in reorganization under Section 77 of the Bankruptcy Act, were using in their operation of the debtor's business the properties of two lessors. Finding the operation of these lines to be unprofitable to the debtor, the court permitted the trustees to reject the leases. However, the lessors being unable to operate their own properties, the Court directed the trustees, pursuant to Section 77 (c) (6) of the Bankruptcy Act, to continue the operation of the rejected lines for and on account of the lessors. The trustees of the New Haven, finding that the rejected leased lines were being operated unprofitably and that the continued diversion of the New Haven's funds to meet the lessors' losses would prejudice the creditors of the New Haven, petitioned for authority to withhold the further payment of the lessors' taxes. The District Court granted the relief sought but the Circuit Court of Appeals reversed, holding that the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a) hereinafter referred to as "Section 124a", required the New Haven's trustees to pay the lessors' taxes so long as they operated the lessors' properties.

In the instant case the trustees are operating only the debtor's business, using under certain leases and operating agreements the properties of the underliers. The trustees have not as yet either rejected or affirmed any of the leases and operating agreements. The Circuit Court of Appeals therefore refused to allow the payment of the underliers' taxes.

The facts of the cases, as well as the opinions of the two courts, clearly show that the two cases involved two different sets of questions. In the *Webster & Atlas* case, the Circuit Court of Appeals for the Second Circuit had to de-

termine (1) whether the trustees of the New Haven were operating the business of its lessors and thus became liable for its taxes, and (2) if they were liable for such taxes, whether the funds of the New Haven should be used to pay them. In the instant case the court below had to determine whether the debtor's trustees were liable for the taxes of the underliers together with the debtor's own taxes not by reason of the fact that they were operating the businesses of the underliers but by reason of the fact that they were alleged to be operating a unified transportation system made up of the commingled properties of the debtor and its underliers. The question involved in each case with respect to the primary problems of the trustees' liability differ so radically that whether or not the Court in the *Webster & Atlas* case erred, after holding that the trustees of the New Haven were liable for its lessors' taxes, in further holding that they were obliged to use the funds of the New Haven to pay the taxes, the two decisions are not in conflict.

The facts of the two cases thus present two entirely different situations with respect to the applicability of Section 124a. That section provides as follows:

> "SEC. 124A. STATE TAXATION: BUSINESS CONDUCTED BY RECEIVERS, TRUSTEES OR OTHER COURT OFFICERS SUBJECT TO
>
> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to

such business the same as if such business were conducted by an individual or corporation: * * *"

Section 124a requires the trustees to pay only such taxes as are assessed against the business operated by them. Under the express wording of this statutory provision, the facts in the *Webster & Atlas* case may well justify the holding that the trustees of the New Haven are required to pay the taxes of its lessors. Upon the entry of the order directing the New Haven's trustees to reject the leases but to continue the operation of the leased lines for and on account of the lessors, the trustees ceased to use the leased lines in connection with their operation of the debtor's business and began to operate them as the separate and distinct businesses of the lessors. This was in accordance with the expressed Congressional intention that they should be so operated after the rejection of the lease, either by the lessor or, if the lessor was unable to do so, by the lessee. Inasmuch as the trustees were operating the lessors' businesses, they became liable for the lessors' taxes under Section 124a.

While the Circuit Court of Appeals for the Second Circuit could hold that Section 124a was applicable in the *Webster & Atlas* case by reason of the trustees' operation of the separate businesses of the lessors, the court below in the instant case was not called upon to make such a finding principally because it is an admitted fact in the case that the debtor's trustees are not operating the separate businesses of the underliers. On the contrary, the court below was requested to hold Section 124a applicable because the trustees were operating some fictitious unified transportation business resulting from their operation of the commingled properties of the debtor and its underliers.

This the court correctly refused to hold because it found that the trustees were only operating the debtor's business, using therein the properties of the underliers.

It is therefore respectfully submitted that the *Webster & Atlas* case and the instant case present two distinct situations requiring different considerations and different results insofar as the question of the respective liabilities of the trustees of New Haven and those of the debtor for the payment of their respective lessors' and underliers' taxes is concerned, and there is, therefore, no conflict between the decisions of the two Circuit Courts of Appeals.

2. In Holding that the Trustees of the Debtor May Not Make Payment of the Underliers' Taxes which Accrued and Became Due and Payable after the Approval of the Debtor's Original Petition for Reorganization, the Circuit Court of Appeals Did Not Decide Important Questions of Federal Law which Have Not Been, but Should Be, Settled by this Court.

(a) THE DECISION OF THE COURT BELOW DOES NOT RAISE AN IMPORTANT QUESTION WITH RESPECT TO THE EXTENT OF THE DUTY OF TRUSTEES APPOINTED UNDER THE BANKRUPTCY ACT TO PAY TAXES ASSESSED AGAINST THE BUSINESS OPERATED BY THEM

No question of the duty of the trustees to pay taxes assessed against the business operated by them arises in this case principally for the reason that respondents have fully conceded that it is the trustees' duty to pay such taxes. Respondents, however, have contended, and the Circuit Court of Appeals has held, that the underliers' taxes are not assessed against the business operated by the trustees. As used by petitioners the phrase "taxes assessed against

the business operated by them" has three possible connotations: (1) taxes assessed against the businesses of the underliers which are being operated by the trustees; (2) taxes assessed against the entire transportation system as a single business; or (3) taxes assessed against the business of the debtor company which is being operated by the trustees. So far as this case is concerned none of the mentioned possibilities presents a question of the duty of trustees in bankruptcy to pay taxes assessed against a business operated by them.

As to the first possible meaning of this important phrase, it is conceded that the trustees are not operating the businesses of the underliers. They have neither been authorized to operate the business of the underliers nor are they in fact operating them. In the order of their appointment (R. 107) the trustees were authorized, *inter alia*, "to preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the debtor, and to manage and conduct its business". The authority of the trustees to conduct business is thus limited to the debtor's business. Furthermore, in their "Summary Statement of the Matter Involved" at page 3 of their petition for writs of certiorari, petitioners admit that the trustees have in fact been operating only the debtor's business, using in their operations the underliers' properties. The first meaning of the phrase therefore raises no question as to the extent of the trustees' duty to pay taxes assessed against the business operated by them.

Nor does the second possible meaning of the phrase, defining the business operated by the trustees as the entire transportation system of the Pittsburgh Railways System, present a question of the trustees' duty to pay taxes. Aside

from the fact that this view ignores the limitation upon the trustees' authority and petitioners' admission that the trustees have limited their operation to the business of the debtor, the acceptance of this interpretation compels the disregarding of the separate corporate entities of the underliers by holding that the underliers' properties are substantially in reorganization. This the Circuit Court of Appeals correctly refused to do. While the properties of the underliers are in the possession of the court and are being used by the trustees, the underliers themselves are not in reorganization and are not under the control and direction of the court. Moreover the very taxes sought to be paid arise solely by reason of the existence of the separate corporate entities of the underliers and bear no relation to their properties being used by the trustees or to the value of the properties to the trustees. Furthermore, the Circuit Court of Appeals felt that the previous history of the debtor which showed a course of conduct upon the part of both the debtor and the petitioners to insist upon their separate corporate identities made it inequitable to disregard them for the purpose of the present case (R. 149).

"Taxes are intensely practical", as stated by petitioners in their brief (page 20), but being practical, they do not ignore the realities of the situation. The acceptance of this second meaning of "business operated by the trustees" completely ignores the realities of the relations between the debtor and its underliers and brings into consideration a fictitious personality having no legal existence and without responsibility. The trustees were appointed for the debtor, to operate the debtor's business, and not for the entire transportation system although they are using properties owned by companies other than the debtor. It is submitted that no question of importance requiring the de-

cision of this court is raised by this contention or the refusal of the Circuit Court of Appeals to adopt it.

Nor does the third meaning of "business operated by the trustees" raise any question of the trustees' duty to pay taxes. This interpretation of the phrase defines the business being operated by the trustees as the business of the debtor and is consistent with the trustees' authority and with ptitioners' statement of the scope of the trustees' operations. It is the view adopted by the Circuit Court of Appeals. Under this interpretation of the phrase the trustees do have a duty to pay the taxes assessed against the debtor's business. The trustees would have a duty to pay the underliers' taxes only if they are assessed against the debtor's business and they would be so only if the debtor's liability for such taxes is a tax liability.

The Circuit Court of Appeals has ruled, and it is submitted, correctly, that the debtors' liability for the taxes of the underliers is not a tax liability but is a part of its contractual rental obligation. (R. 147). In arriving at this result the court was merely following its previous decision in *Philadelphia & Reading Coal & Iron Co. v. Van Deusen,* 103 Fed. (2d) 869, and the case of *Hardeman v. Hendrix,* 29 Fed. (2d) 738 (C. C. A., 5th Cir.). A similar conclusion was reached by the Circuit Court of Appeals for the Second Circuit in the case of *American Brake Shoe Foundry Company v. New York Railways Company,* 282 Fed. 523. No reported case to the contrary has been found. In view of the unanimity among the Circuit Courts of Appeals on this question, it is submitted no important question of Federal law requiring this court's determination is presented by this holding.

Having properly decided that the debtor's obligation for the underliers' taxes is only part of the contractual obli-

gation of the lease agreement, the Circuit Court of Appeals was correct in holding that the trustees should not pay the underliers' taxes until the court has determined the extent of the use of the underliers' property and the net earnings being derived therefrom or its value. In arriving at this conclusion the Circuit Court of Appeals made no new departure but followed the settled decisions of this court and other Federal courts. *United States Trust Co. v. Wabash Railway*, 150 U. S. 287; *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721; *American Brake Shoe & Foundry Co. v. New York Rys. Co.*, 282 Fed. 523; *Westinghouse Electric & Mfg Co. v. Brooklyn Rapid Transit Co.*, 6 Fed. (2d) 547; *In re Connecticut Co.*, 95 Fed. (2d) 311, cert. den. sub nomine *Connecticut Railway & Lighting Co. v. Connecticut Co.*, 304 U. S. 571. The opinion of the Circuit Court of Appeals well summarizes these holdings (R. 150):

> "The trustees have no obligation to pay the rentals due under the leases, as such, unless and until they affirm the leases and operating contracts. They have a reasonable time within which to affirm or disaffirm. During the interim their sole obligation is to pay the lessors a reasonable amount for the use and occupation of the properties actually in use. This rule, which was originally laid down in railroad receiverships in equity applies to the reorganization of a street railway under Section 77B of the Bankruptcy Act. If an interim payment is made it is ordinarily held that it should not be in an amount in excess of the net earnings derived from the operation of the lessor's properties."

The requirement that the net earnings of each under-

lier's property or the value of its use to the debtor's estate be shown before such payments can be made is a necessary corollary to the quoted rules. Prior to its present decision the Circuit Court of Appeals had already held in *Public Service Commission v. Philadelphia Rapid Transit Company*, 82 Fed. (2d) 481, that such interim payments could not be made until the requisite facts were shown. Certiorari was denied by this court sub nom. *Citizens Passenger Rys. Co. et al. v. Public Service Commission*, 298 U. S. 673.

It is respectfully submitted that the decision of the Circuit Court of Appeals does not decide any question of the trustees' duty relative to taxes assessed against a business operated by them by reason of the fact that the taxes of the underliers are not taxes assessed against the business operated by the trustees.

(b) THE DECISION OF THE COURT BELOW DOES NOT RAISE AN IMPORTANT QUESTION AS TO THE INTERPRETATION OF SECTION 124a.

What has been stated in the discussion immediately preceding applies with equal force to the instant question. In order for Section 124a to be applicable it must be shown (1) that the debtor's liability for the underliers' taxes is a tax liability, and (2) that the trustees have been authorized to operate or are in fact operating the underliers' businesses. As shown above the debtor's liability for the underliers' taxes is only a contractual obligation. As also shown above the trustees have not been authorized to operate the businesses of the underliers, nor are they in fact operating such businesses. Section 124a is therefore clearly not applicable and no important question of its interpretation is raised by the decision.

(c) THE DECISION OF THE COURT BELOW DOES NOT RAISE SERIOUS CONSTITUTIONAL QUESTIONS WHICH SHOULD BE DECIDED BY THIS COURT.

While some of the petitioners urged in the District Court that the refusal to pay the underliers' taxes was inequitable and permitted the diversion of the net earnings of the underliers to pay the tax obligations of the debtor, none of them has ever contended either before the Special Master, the District Court or the Circuit Court of Appeals that the refusal to pay the underliers' taxes would result in the taking of property without due process of law in contravention of the Fifth Amendment to the Constitution of the United States. The matter has been raised for the first time in the petition for the writs of certiorari. This court has held that it will not consider objections and assignments of error that were not raised in the courts below. *Burbank v. Bigelow,* 154 U. S. 558, *Saltonstall v. Birtwell,* 164 U. S. 54, *Lutcher & Moore Lumber Co. v. Knight,* 217 U. S. 257. The issue presented by this assignment of error could have been raised in either of the courts below.

But even if the matter is properly raised, it is submitted that no question of depriving the underliers of their property without due process of law is raised by the petition. The claims of the underliers for use and occupancy accruing during the period of administration are administration expenses and have the priority of such expenses. However, under the doctrine of *Michigan v. Michigan Trust Company,* 286 U. S. 334, and the companion cases cited in petitioners' brief, the tax liability of the debtor is entitled to priority over other administrative expenses and should be first paid as "the price that business has to pay for protection and security." Moreover, the Circuit Court has not

held categorically that the taxes of the underliers can never be paid by the debtor's estate. It has only refused to permit the payment on the basis of the record before it. The court has only held, as respondents have contended throughout the proceeding, that the trustees may not pay out moneys of the estate for claims for use and occupancy until the underliers have established their claims by showing in some manner the extent of the use and occupancy and its value. A decision which recognizes the propriety of the allowance if the claimant will establish its claim by competent evidence, as does the decis[illegible] the Circuit Court of Appeals, does not deprive a claimant of property without due process of law. On the contrary the Circuit Court of Appeals regarded the entry of an order, such as that of the District Court, directing the payment of the underliers' taxes without requiring the claims and the amounts thereof to be established, as having been entered without factual basis and as arbitrary and possibly confiscatory. Such an order would result in depriving *respondents* of their property without due process of law. The decision of the Circuit Court of Appeals does not therefore, it is submitted, raise any question under the Fifth Amendment to the Constitution of the United States.

For the foregoing reasons it is submitted that the petition for writs of certiorari in so far as it applies to taxes of the underliers accruing after the filing of the petition for reorganization should be denied.

B.

Taxes which Accrued and the Liability for which Became Fixed Prior to the Filing of the Petition for Reorganization.

What has been said before with respect to the taxes which accrued subsequent to the filing of the petition for

reorganization applies with equal force to the instant group of taxes. However, additional reasons exist why certiorari should be denied as to these taxes. The taxes involved are Federal Income Taxes for the year 1937 and Federal income taxes withheld at source for 1937, due and owing on March 15, 1938, and Pennsylvania net income taxes for 1937, due and owing April 15, 1938. As to these taxes the taxpayer had an option to pay them under the statutes at a later time, which was subsequent to the filing of the petition for reorganization on May 10, 1938. These taxes the Circuit Court of Appeals held were not administration expenses but items due and owing at the time of the filing of the petition. In arriving at this conclusion, the Court was in accord with this court in the case of *New Jersey vs. Anderson*, 203 U. S. 483, where it was held that the controlling factor is the time of the accrual of the obligation to pay rather than the time that actual payment is to be made. In the instant case the obligation of the underliers to pay these taxes had accrued and the debtor's obligation under its leases had also accrued. The claims of the underliers for the payment of these taxes were therefore only simple contract unsecured claims. Regarding the claims as unsecured claims no reasons exist for the granting of certiorari.

1. With Respect to this Group of Taxes the Decision of the Court Below Is Not in Conflict with the Decision of the Circuit Court of Appeals for the Second Circuit in Webster & Atlas National Bank of Boston v. Palmer et al., 111 Fed. (2d) 215, Decided April 16, 1940.

In the *Webster & Atlas* case the only taxes involved were taxes of the lessor accruing during the period of administration, all prior taxes having been paid, 111 Fed. (2d)

217. Insofar as the decision of the Circuit Court of Appeals in the instant case dealt with these taxes, it was treating with a question and subject matter not involved in the *Webster & Atlas* case and the decisions cannot be said to be in conflict:

2. In Holding that the Trustees of the Debtor May Not Make Payment of the Underliers' Taxes which Accrued Prior to the Filing of the Petition for Reorganization but Became Payable Thereafter, the Circuit Court of Appeals Did Not Decide Important Questions of Federal Law Which Have Not Been, but Should Be, Settled by this Court.

(a) THE DECISION OF THE COURT BELOW DOES NOT RAISE AN IMPORTANT QUESTION WITH RESPECT TO THE DUTY OF TRUSTEES APPOINTED UNDER THE BANKRUPTCY ACT TO PAY TAXES ASSESSED AGAINST THE BUSINESS OPERATED BY THEM.

Inasmuch as the debtor's liability for the underliers' taxes is only a contractual obligation, the claims of the underliers are not claims for taxes assessed against the business operated by the trustees and the trustees have no duty with respect to their payment other than to provide in a plan of reorganization for their payment in the same manner and to the same extent as other similar unsecured claims. Even, however, if the debtor's liability was a tax liability, the trustees would have no duty with respect to these taxes other than to provide for their payment in the plan of reorganization.

(b) THE DECISION OF THE COURT BELOW WITH RESPECT TO TAXES ACCRUED PRIOR TO THE FILING OF THE PETITION FOR REORGANIZATION DOES NOT RAISE AN IMPORTANT QUESTION AS TO THE INTERPRETATION OF SECTION 124a.

The purpose of Section 124a is to oblige a trustee who operates a business to pay the taxes assessed against such business during his operation. It does not purport to deal with all taxes owed by the debtor and it does not purport to deal with tax obligations of the debtor which accrued prior to the operation of the business under the direction of the court. The language of the statute itself discloses that insofar as the taxes now under discussion are concerned no question of the interpretation of Section 124a is involved.

(c) THE DECISION OF THE COURT BELOW WITH RESPECT TO TAXES ACCRUED PRIOR TO THE FILING OF THE PETITION FOR REORGANIZATION DOES NOT RAISE SERIOUS CONSTITUTIONAL QUESTIONS WHICH SHOULD BE DECIDED BY THIS COURT.

The decision of the Circuit Court of Appeals refuses to permit the payment of claims of certain of the debtor's unsecured creditors in advance of those of the other unsecured creditors but compels the payment of their claims to await the confirmation of a plan of reorganization which will provide for the participation in the reorganized debtor of all claimants entitled to participate therein. Such a decision does not deprive the underliers of their property without due process of law but is in entire accord with the bankruptcy powers conferred upon Congress by the Constitution of the United States, the Acts of Congress relating to Bankruptcy and the decisions of this Court.

It is submitted that the decision of the court below with respect to this group of taxes discloses no reason to move this court to grant writs of certiorari.

Conclusion

It is respectfully submitted that the Circuit Court of Appeals did not err in reversing the order of the District Court insofar as it authorized the payment of the underliers' taxes and that the decision of the Circuit Court of Appeals does not conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Webster & Atlas National Bank of Boston v. Palmer et al.*, 111 Fed. (2d) 215, and does not present important questions of Federal law requiring the decision of this court; and it is respectfully submitted that the petition for writs of certiorari should be denied.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NOS. 242 AND 243.

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

BRIEF FOR RESPONDENTS.

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INDEX.

Table of Authorities.

CASES.

STATUTES.

TEXTS AND ARTICLES.

Blank Page

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BRIEF FOR RESPONDENTS.

I.

OPINIONS BELOW.

The opinion of the District Court (McVicar, J.) has not yet been officially reported; it appears at pages 78 to 83 of the Record. The opinion of the Circuit Court of Appeals (Maris, C. J.) is reported in 111 F. (2d) 932, and will be found at pages 104 to 110 of the Record.

II.

JURISDICTION.

The Circuit Court of Appeals entered its orders on April 30, 1940 (R. 110). On June 12, 1940, said orders were vacated (R. 111, 112), and amended orders were entered (R. 112, 113). No petition for rehearing was filed. The jurisdiction of this Court is invoked under Sec. 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, Chap. 229, Sec. 1, 28 U. S. C. A. Sec. 347, since this is a cause on which final orders of a Circuit Court of Appeals have been entered. The petitions for writs of certiorari were filed on July 15, 1940, and the writs were granted October 14, 1940 (R. 115).

III.

COUNTER-STATEMENT OF THE CASE.

The Pittsburgh Railways Company was organized by a special Act of the Pennsylvania Legislature in 1871. The Pittsburgh Railways System is composed of 580 miles of track, car barns, repair shops, incline properties and buses. The Pittsburgh Railways Company is the owner of a portion of the track; the remainder of the track has been operated by it since 1902 by virtue of operating agreements and leases from 55 separate underlying companies (R. 62). All of its capital stock is owned by the Philadelphia Company, one of the petitioners herein (R. 75). The Pittsburgh Railways Company controls the stock of certain of the underliers; the stock of the other underliers is owned by other interests.

The lease and operating agreements with the underliers require the Pittsburgh Railways Company to pay expenses of operation and ordinary maintenance, and all Federal, State, County and municipal taxes assessed

against the underliers, or which by any present or future law or by contract the underliers may be required to pay (R. 7). Prior to the date of these proceedings, all tax payments theretofore payable by the underliers had been paid by the Pittsburgh Railways Company (R. 7). On May 10, 1938, the Pittsburgh Railways Company together with the Pittsburgh Motor Coach Company, a wholly owned subsidiary, filed voluntary petitions in the District Court of the United States for the Western District of Pennsylvania, to effect a plan of reorganization under the provisions of Section 77B of the Bankruptcy Act. Orders were made continuing the debtors in possession, with authority to operate their businesses (R. 1). On June 14, 1938, Trustees were appointed for the debtor Railways Company, and the Trustees were authorized to preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the debtor, to manage and conduct its business, and to pay all taxes and assessments due or to become due upon the property in possession of and/or owned by the debtor (R. 6).

The Trustees continued to operate the business of the debtor Railways Company. Pursuant to the court order, the Trustees have since their appointment been operating the business of the debtor, using in their operation the properties of the underliers.

On March 10, 1939, the Trustees of the debtor Railways Company petitioned the District Court for instructions with respect to the payment as an administration expense of certain taxes assessed against the debtor, the subsidiary and the underliers (R. 6).

None of the taxes of the underliers was assessed against the Pittsburgh Railways Company. The obligation of the debtor with respect to these taxes arose under the lease and operating agreements with the 55 underliers, which provided that the Railways Company should

pay all taxes assessed against the underliers (R. 7). The taxes of the debtor involved are the Pennsylvania Capital Stock Tax, Pennsylvania Corporate Net Income Tax and Pennsylvania and Federal Social Security Taxes, some of which taxes had accrued and become payable subsequent to the filing of the petition for reorganization and some of which had accrued prior thereto. The taxes of the underlying companies involved are Pennsylvania Capital Stock Taxes, Pennsylvania Corporate Net Income Taxes, Pennsylvania Corporate Loans Taxes and Federal Income Taxes, some of which taxes had accrued and become payable subsequent to the filing of the petition for reorganization and some of which had accrued prior thereto. The taxes of the subsidiary involved are Pennsylvania Capital Stock Tax and State and Federal Social Security Taxes, all of which became due after the filing of the petition for reorganization, and the employer's share of the Federal Old Age Benefits tax, which became payable prior to the filing of the petition (R. 8).

The Trustees' petition was referred to a Special Master, Watson B. Adair (R. 21). Objections to the payment of the taxes were filed by the Tort Creditors' Committee, intervenor (R. 21). Objections to such payment were made by the City of Pittsburgh, a large creditor (R. 57).

Testimony was adduced before the Master, including the fact that no decision had been reached by the Trustees as to which, if any, of the underliers would be included in the plan of reorganization. There was testimony that no determination had been made with respect to the net earnings of each of the underliers (R. 63). The Trustees neither affirmed nor disaffirmed the leases and operating agreements between the debtor Railways Company and the 55 underliers (R. 62).

On August 22, 1938, the Master filed his report (R. 55 to 72) recommending that the taxes of the debtor and

subsidiary which had accrued subsequent to the filing of the petition for reorganization should be paid by the Trustees, and that the taxes of the debtor and the subsidiary which had accrued prior to the filing of the petition, or about which there was some doubt as to when they accrued, *and all the taxes of the underliers, should not be paid by the Trustees at present.* His decision as to the nonpayment of the taxes of the underliers, whether accrued before or after the filing of the petition for reorganization, was predicated upon the fact that it was uncertain that any of the leases would be affirmed by the Trustees, and that in the absence of any evidence that the net earnings of each underlier were equal to its taxes, payment of the taxes might result in a preferment or overpayment. It was held further, that certain claims of the debtor against the underliers might extinguish any existing equities (R. 67).

Exceptions to the Master's Report were filed by the Philadelphia Company and certain of the underliers and by Samuel H. Putnam, a creditor (R. 72, 76, 77, 78). Argument was held before the Hon. Nelson McVicar, District Judge. Following the argument, counsel for the Trustees filed a recommendation with Judge McVicar in which they recommended that all of the taxes set forth in Trustees' petition for instructions be paid, save certain Federal taxes of the underliers and the underliers' corporate net income taxes, until their liability therefor should be determined (R. 93). On October 26, 1939, Judge McVicar filed an opinion holding that the taxes of the underliers be paid, with certain minor exceptions. The District Court held that the Pittsburgh Railways System had been operated as a unit since 1902, and that the income derived from the various underliers had been kept in one fund and treated as one fund, and, therefore, held that the taxes of the underliers should

be treated as taxes of the debtor (R. 78 to 83). The Court thereupon entered an order directing the Trustees to pay all the taxes of the debtor, the underliers and the subsidiary to the extent that their payment was recommended by counsel for the Trustees (R. 83).

The Tort Creditors' Committee and the City of Pittsburgh appealed to the Circuit Court of Appeals for the Third Circuit from such portion of the order as directed the payment of underliers' taxes (R. 86, 87).

On April 30, 1940, the Circuit Court of Appeals, after hearing, reversed the District Court, in an opinion written by Albert B. Maris, C. J., and held that the debtor's Trustees were not liable for the underliers' taxes (R. 104 to 110). It was the opinion of the Circuit Court that the obligation of the debtor to pay the taxes was an additional consideration for the use of the underliers' property and was, therefore, a rental obligation and not a tax liability. The Circuit Court refused to adopt the view that the separate corporate entities of the underliers should be disregarded; the underliers had refrained from filing petitions for reorganization and were not subject to the jurisdiction of the Court. The Circuit Court was of the opinion that the Trustees, until the affirmation of the leases and operating agreements, had as their sole obligation the duty to pay lessors a reasonable amount for use and occupation, which amount could not be in excess of the net earnings derived from the operation of the lessors' properties. The Court held that before any payment could be made it would be first necessary for the Court to determine the property which was being used, the extent of its use, and the net earnings being derived therefrom or its value.

Petitions for writs of certiorari were filed by the Philadelphia Company and certain of the underliers on June 15, 1940, and writs of certiorari were granted on October 14, 1940 (R. 115).

IV.

SUMMARY OF ARGUMENT.

The problem involved in the case at bar is not a tax problem. The debtor's sole liability for the taxes of the underliers arises out of its covenants in the leases with the underliers wherein the debtor assumed and agreed to pay as part of the consideration under the agreements all the taxes of the underliers. The obligation imposed upon the debtor by such covenants is not a tax obligation but a mere contractual obligation. Inasmuch as the debtor's obligation is merely contractual, the liability of the Trustees for the underliers' taxes is of no higher dignity and status. With respect to taxes of the underliers which accrued subsequent to the filing of the petition for reorganization, the Trustees have the same duty as to their payment as they have for any other obligation under their debtor's executory contracts. With respect to taxes of the underliers which accrued prior to the filing of the petition, the underliers have only an unsecured general contract claim arising from the debtor's failure to pay the taxes.

The Act of Congress of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. Sec. 124a), which provides that any trustee appointed by any United States Court, who is authorized by said Court to conduct any business, shall be subject to all State and local taxes applicable to such business, did not convert the Trustees' obligation under the leases with respect to the underliers' taxes into a tax obligation. Section 124a imposes upon the Trustees no greater tax obligation than would be imposed on the debtor if not in reorganization. The Trustees are not operating the businesses of the underliers (which underliers are not in reorganization) but are merely utilizing their properties in the operation of the debtor's business

to the same extent that the debtor used the underliers' properties prior to reorganization. A construction of Section 124a which limits the Trustees' obligation to the precise limits of the debtor's obligation prior to reorganization, will not deprive petitioners of their property without due process of law contrary to the Fifth Amendment of the Constitution. The inability of the underliers to have their taxes paid is the result of their own conduct. The adoption of petitioners' construction may materially injure respondents by reducing the funds available for the payment of unsecured creditors.

There is neither authority nor sound reason for holding that it is the duty of receivers or trustees to pay the taxes of lessor companies, which are not in reorganization, merely because the Trustees are using the properties of the underliers in connection with the operation of the debtor's business.

The Trustees' obligation to pay the taxes of the underliers which accrued after the filing of the petition for reorganization is governed by the rules with respect to executory contracts. The Trustees are only liable, pending affirmance or disaffirmance of the leases and operating agreements, for use and occupancy of the properties of the underliers, which in the case of railways is measured by net earnings. No evidence was adduced as to the extent of the net earnings. Consequently, the underliers are not entitled at this time upon the present record to an order directing the Trustees to pay the taxes of the underliers or to advance any funds until their respective net earnings are established.

V.

ARGUMENT.

It is not often that a holding company blandly asserts that its intricate intercorporate structure should be ignored, and insists that when the debtor company took possession of the properties of the underliers "the underliers became a mere corporate shell." (Petitioner's Brief, p. 12). Such bold assaults upon the integrity of the separate legal entities of the underliers are usually made by disgruntled creditors and intransigeant taxpayers.

In the case at bar, however, it is the grandparent holding company* which impugns the sanctity of the separate corporate entities of the fifty-five underlier companies and urges this Court to hold that taxes assessed against the fifty-five underliers should be paid by the debtor corporation, the Pittsburgh Railways Company. And it is the general unsecured creditors who are insistent that the underlier corporations which have been kept intact and carefully nurtured for several decades, the securities of many of which are publicly owned, be compelled to retain their separate corporate existences and concomitant responsibilities.

The taxes which are involved in the instant case were levied and assessed against the various *underlying companies* and not against the Pittsburgh Railways

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* The Philadelphia Company owns all the stock of the Pittsburgh Railways Company, which in turn has an investment of $32,000,000.00 in the stock of the underliers (R. 106). The Philadelphia Company owns directly or indirectly the stock of thirty-eight of the underliers (R. 17, 18). The rest of the underliers are owned by outside interests.

Company, debtor in reorganization. These taxes, amounting to $285,203.93, were levied upon the capital stock, corporate loans and incomes of the lessor underlying companies by the Federal and State authorities.

The lease and operating agreements governing the underliers' properties in the possession of the Pittsburgh Railways Company contain clauses whereby the lessee Railways Company agreed to pay, in addition to the rent and other charges, all Federal, State and municipal taxes assessed against the lessor or which by any future law or by contract the lessor may be required to pay (R. 7). The lease and operating agreements have been neither affirmed nor disaffirmed by the Trustees of the debtor in reorganization (R. 62). While the properties of the underliers are in the possession of the Trustees for the Pittsburgh Railways Company and are being used and operated by the Trustees together with the properties of the debtor, none of the underlying companies has submitted itself to reorganization with the debtor (R. 66).

It was the position of the Trustees of the Pittsburgh Railways Company and is the position of the Philadelphia Company, Petitioner, which owns all of the stock of the debtor, that the Court should ignore the separate corporate identities of the debtor and its fifty-five underlying companies and treat them all as one unified transportation system. It is urged that the taxes of the underlying companies are in practical effect the taxes of the unified system and should, therefore, be paid as administrative expenses by the Trustees of the debtor in reorganization.

It is earnestly submitted that this proposition is wholly untenable. It negatives the legal effect of the separate corporate structures of the underliers and ignores the salient fact that none of these taxes was

assessed or levied against the debtor in reorganization. Its adoption would inevitably operate to the advantage of the holding company and the underliers, and to the impairment of the rights of creditors of the debtor in reorganization.

I. There Is No Tax Liability Upon the Trustees of the Lessee Debtor by Virtue of the Lease and Operating Agreements With the Underliers.

The taxes in question* fall naturally into two broad classifications:

1. Taxes assessed against the underliers since the commencement of the reorganization proceedings, totaling $153,302.19.

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* Unpaid balances of Federal income taxes for the year 1937, payments due June 15, September 15, and December 15, 1938 .. $ 97,412.14
Federal income taxes for the year 1937 withheld at source in respect to interest upon obligations of underliers, payment due June 15, 1938 ..... 6,850.01
Pennsylvania corporate net income taxes for the year 1937, payment due May 15, 1938 ..... 27,639.59
Federal income taxes for the year 1938 .... 50,501.26
Federal income taxes for the year 1938, withheld at source with respect to interest upon obligations of underliers 2,668.08
Pennsylvania corporate net income taxes for the year 1938 ..... 18,335.72
Pennsylvania capital stock taxes for the year 1938 ..... 64,294.57
Pennsylvania corporate loans taxes for the year 1938 in respect to interest upon the obligations of underliers 17,502.56

Total $285,203.93

2. Taxes assessed against the underliers prior to the commencement of the reorganization proceedings, totaling $131,901.74.

1. *Taxes Which Accrued Subsequent to Reorganization.*

Certain of the taxes involved in this proceeding admittedly accrued *after* the filing of the debtor's petition for reorganization. The taxes falling within this category are the Federal Income taxes of underliers for 1938, Federal Income taxes for 1938 withheld at source with respect to obligations of underliers, Pennsylvania Capital Stock taxes of underliers for 1938, Pennsylvania Corporate Loans taxes of underliers for 1938, and Pennsylvania Corporate Net Income taxes of underliers for 1938 (R. 6 to 20).

All of these taxes were levied and assessed against the various underlying companies and not against the Pittsburgh Railways Company, the debtor in reorganization. None of the underlying companies is in reorganization, nor do the taxes bear any relation to the properties leased by the underliers to the debtor (R. 67).

It is respectfully submitted that cogent reasons must be advanced for imposing upon the Trustees of a debtor lessee the tax obligations, not of the debtor lessee, but of fifty-five underlying companies having separate corporate structures from 1902 to the present time. It is earnestly submitted that an examination of the arguments advanced by counsel for petitioners to buttress the claim for payment by the Trustees of the underliers' taxes assessed after the institution of the reorganization proceedings, prove them to be unsupported by either sound reasoning or reported judicial thinking.

The liability of the Trustees of the debtor company for the taxes of the underliers depends entirely upon the

nature of the debtor's obligation for such taxes. The sole source of the debtor's liability for the underliers' taxes is found in the lease and operating agreements between the Pittsburgh Railways Company and the underliers, which require the Pittsburgh Railways Company to pay in addition to all expenses of operation and ordinary maintenance, all taxes assessed against the underliers, or which by future law or by contract the lessor underliers may be required to pay (R. 7).

The Pittsburgh Railways Company by these covenants did not become liable for the taxes of the underliers as a taxpayer; the obligation assumed thereby was purely a contractual one. The taxes continued to be levied and assessed against the underliers, and the Pittsburgh Railways Company paid them in addition to rent and other payments required by the lease and operating agreements.

The distinction between the tax obligation of the debtor and its obligation with respect to taxes of the underliers assumed by it as lessee under the lease agreements is real and of controlling importance in analyzing the issues presented by the case at bar. For if the debtor's covenant to pay the underliers' taxes is a contract and not a tax obligation, then it follows that the obligation of the debtor's Trustees is likewise not a tax obligation.

The validity of the distinction here made was fully recognized by the Court below. We quote from the opinion of the Hon. Albert B. Maris, C. J., in the case at bar, 111 Fed. (2d) 932, at p. 933 (R. 105):

> "The sole obligation of the debtor with respect to these taxes arose under the leases and operating agreements with the underliers which provided that the debtor should pay all taxes assessed against the underliers. The obligation of the debtor to pay the

taxes was an additional consideration for its use of the underliers' property, and, therefore, as to it a rental obligation rather than a tax liability."

In *Hardeman v. Hendrix,* 29 F. (2d) 738 (C. C. A. 5th Circuit, 1928), a similar conclusion was reached. There the bankrupt leased property at a stipulated rental and agreed to pay all taxes and assessments against the property. The Court held the bankrupt's obligation was not a tax obligation. We quote from the Opinion of the Court at page 739:

> "The bankrupt agreed to pay both the taxes and the sidewalk assessment as a part of the rent and his failure to do so was no more than a breach of contract. The balance due by the bankrupt is for rent, and doubtless constitutes a provable claim, but it cannot be given the priority that attaches to taxes due and owing by a bankrupt on his property."

Even where the taxes assumed by the lessee were real estate taxes assessed against the very properties leased, the obligation was held not to be a tax obligation.

In *Philadelphia and Reading Coal & Iron Co. v. Van Deusen,* 103 F. (2d) 869 (C. C. A. 3d. Cir. 1939, certiorari denied October 9, 1939, 84 L. Ed. 77), where the debtor coal mining company had agreed to pay the taxes assessed against the leased properties, the claim of the lessor was declared to be an unsecured claim and not a tax claim. We quote from the Opinion of the Court at p. 871:

> "The taxes levied from time to time upon the real estate were not shown to bear any relation to the value either of the coal actually removed or of the building sites actually demised. In the absence of such evidence the court properly declined to allow the claim for the sums paid in taxes as in the

nature of payments for use and occupation. Since the taxes as such had been paid the taxing authorities had no further interest in the matter. *Nor was it ever a tax obligation of the debtor.* Hardeman et al. v. Hendrix (C. C. A., 5th Cir.), 13 Am. B. R. (N. S.) 314, 29 F. (2d) 738. The appellants have a general unsecured claim under the agreement against the debtor for repayment of the taxes, which is postponed to all claims having priority. The District Court did not err in disallowing this claim." (Italics ours)

A similar conclusion was reached by the Circuit Court of Appeals for the Second Circuit in the case of *American Brake Shoe Foundry Company v. New York Railways Company,* 282 Fed. 523.

The case of *In re Brown,* 123 Fed. 639 (D. C., W. D. N. Y., 1903), is consonant with established authority, and holds that the lessors of the debtor bankrupt have no more than a contract claim for the taxes the bankrupt has failed to pay under the lease.

From the principles enunciated in the foregoing cases, it is clear that the debtor's obligation by virtue of the covenants in the leases with the underliers in the case at bar is not a tax obligation, but a contract obligation. It might as logically be argued that in the absence of the covenant to pay taxes, such as is contained in the lease agreements here involved, proof that part of the rental was used by the underliers to pay taxes would render the Trustees of the debtor in reorganization liable for the payment of such taxes. The conclusion is ineluctable that the obligation of the Trustees of the debtor under these leases is no greater than that of the debtor. The underlying lessor companies have, therefore, by virtue of the lease covenants, nothing more than a general contract claim and not a tax claim payable by the Trustees as an administrative expense.

2. *Taxes Which Accrued Prior To Reorganization But Which Were Payable Thereafter.*

It is submitted, moreover, that the debtor Railway Company has a contractual and not a tax obligation for the taxes which became due *prior* to the commencement of the reorganization proceedings. (See Schedule of taxes, p. 11 of this Brief.) The failure of the debtor to pay these taxes was a breach of the lease and operating agreements, and the amounts thereupon became due as contract claims against the debtor in reorganization and are not tax liabilities payable by the trustees of the debtor as an administrative expense.

The specific taxes falling within this category are:

A. Federal Income taxes assessed against the underliers for the year 1937, which accrued on January 1, 1938 and became due March 15, 1938. (R. 60, Revenue Act of 1936, Sec. 53 (a) 1, 26 U. S. C. A. Sec. 53 (a) 1.) This was prior to May 10, 1938, the date of the filing of the petition for reorganization. These taxes could by law be paid in quarterly installments.

B. Federal Income taxes for 1937, withheld at source, in respect to interest upon the obligation of underliers, (R. 59, Act of May 10, 1934, c. 287, Sec. 143 (c), 26 U. S. C. A. Sec. 143 (c).) These taxes accrued January 1, 1938 and became due on March 15, 1938, prior to the filing of the petition for reorganization, although payable any time prior to June 15, 1938.

C. Pennsylvania Corporate Net Income taxes assessed against the underliers for the year 1937. (R. 85, Pa. Act of May 16, 1935, P. L. 208, as amended, 72 Purd. Stat. Sec. 3420 (d).) These taxes accrued January 1, 1938 and became due April 15, 1938, prior to the date of

the filing of the petition for reorganization, although payable any time prior to May 15, 1938.

It appears to be well settled that the controlling date for determining when an obligation is due and owing for bankruptcy purposes is the time of accrual of the obligation to pay the tax rather than the time when the tax obligation is to be discharged by payment:

New Jersey v. Anderson, 203 U. S. 483 (1906);
In re International Match Corp., 79 F. 2d, 203, 205 (C. C. A. 2d 1935), certiorari denied sub nom. Delaware v. Irving Trust Co., Trustee, 296 U. S. 652 (1935).

Since the authorities hereinbefore adverted to (this Brief p. 14 *et seq.*) clearly state that the lessee has no tax obligation for taxes payable by virtue of the covenants in the leases with the lessors, the same principle can be invoked with even greater force with respect to taxes that accrued prior to the commencement of reorganization proceedings but that were payable thereafter.

It is, therefore, respectfully submitted that with respect to taxes, which accrued prior to the reorganization proceedings, the underliers are in the same position as general creditors and under no accepted legal theory can their claims be converted into preferred tax claims. As was succinctly stated by the Hon. Albert B. Maris, Circuit Judge, in the Opinion written by the Circuit Court in the case at bar, reported at 111 F. (2d) at p. 932 (R. 107):

> "Even though the taxpayer was given the option to pay these taxes in installments the taxes were actually due on the dates mentioned, which were the dates fixed by law for filing the tax returns. The failure of the debtor to pay these taxes was a

breach of the leases and operating agreements and the amounts then due became simple contract claims against the debtor, due when the debtor's petition was filed. As to these claims the underliers must take their position with all other general creditors."

It thus appears that whether the taxes of the underliers accrued prior or subsequent to reorganization they are not tax obligations of either the debtor or the Trustees of the debtor in reorganization by virtue of the covenants contained in the lease and operating agreements.

II. The Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. Sec. 124a) Does Not Require the Trustees of the Lessor to Pay State Taxes Assessed Against Underliers.

The Trustees appointed in the case at bar for the debtor Railways Company were authorized by the Court to—

> "preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the Debtor, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues and profits of said property and estate; * * *"

and

> "to pay all taxes and assessments due or to become due upon the property in possession of and/or owned by the Debtor; * * *". (R. 6).

Under authority of this order the Trustees have been operating the business of the debtor company, and in connection therewith are utilizing the properties of the underliers embraced in the lease and operating agreements.

It is urged by Petitioners that the provisions of the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a), impose upon the Trustees the duty to pay all State and local taxes assessed against the underliers. The basis for this contention is found in the fact that the Trustees have been operating the debtor's business, utilizing the properties of the underliers covered by the leases, under an order of Court.

It is submitted that the interpretation sought by Petitioners to be imposed upon this Section is disconsonant with the provisions of the Statute and finds no support in judicial authority. Section 124a provides as follows:

> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: * * *"

This statute was enacted in recognition of the fact that business, whether in receivership or not, should pay the price for the protection and security afforded it by government.

The natural interpretation of the language of the Act is to impose upon the Trustees the same responsi-

bility as to taxes that the debtor had prior to the commencement of reorganization proceedings. Such was the clear intention of Congress in enacting this legislation.* Since the debtor's obligation for the state taxes of the underliers was a contractual and not a tax obligation, it follows that the Trustees' obligation is likewise not a tax obligation, and that it is not converted into a tax obligation by the provisions of Section 124a. Section 124a does not purport to impose a heavier tax obligation upon the Trustees than the debtor would have if no reorganization proceeding were pending, but only to maintain the same liability.

The District Court seemingly gave great weight to the argument of both the Trustees of the debtor and the

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* The interpretation placed by respondents upon Section 124a is borne out by the Report of the House Committee on the Judiciary, House Report No. 1138 of the 73d Congress, 2nd Session, on the Act when pending in Congress. The report states:

"The purpose of this bill is to subject businesses conducted under receivership in Federal Court to State and local taxation the same as if such businesses were being conducted by private individuals or corporations.

"The United States District Court for the Western District of Missouri in the case of *Howe v. Atlantic, Pacific & Gulf Oil Co. et al. (State of Missouri et al., Intervenors)* (4 Fed. Supp. 162) recently held that a receiver operating a gasoline-and-oil distributing business under appointment by the Federal Court was not liable for a sales tax on motor fuel levied by the State of Missouri. As a consequence of this decision, your committee is advised, the State of Missouri and other States having similar Statutes are losing thousands of dollars of revenue per month.

"No good reason is perceived why a receiver should be permitted to operate under such an advantage as against his competitors not in receivership, and the States and local governments be deprived of this revenue."

Philadelphia Company, holder of all its stock, that the integration of the system necessitated and justified the payment by the Trustees of the debtor of the taxes of the underliers. In doing so it completely disregarded the Master's Report which recommended a contrary order (R. 72). Watson B. Adair, Master, made this specific finding with respect to the taxes of the underliers (R. 67):

"Taxes on Underliers.

24. It is uncertain that any of the leases or operating agreements will ever be accepted by the trustees. Unless they be accepted, their covenants for payment of taxes will not bind the estate to pay the taxes of the underlying companies as administration expenses. There is no showing that the amounts, if any, owing to the respective companies for the net earnings of their properties or for the use of their properties by the trustees are proportionate to their taxes or even that in every case they are as much as their taxes. Payments of taxes regarded as payments for such earnings or use might give some companies a greater proportion of their dues than others and might even overpay some. If the debtor's claims (paragraph 17) against some of the underlying companies be meritorious, they may affect the equities. There does not appear to be any exigency which might justify the risk of effecting preferences or overpayments. It does not seem practicable to deal with the underliers' taxes in the mass, or to dispose of them separately upon the facts shown. At present the taxes of the underliers should not be paid by the trustees."

No case was cited by the District Court which in fact supports the extraordinary doctrine enunciated by it that the debtor's Trustees are responsible for the taxes

of underliers. The cases cited by the Court and which are relied upon by the Petitioners herein are all cases where the petitioners now frankly concede the *taxes were assessed and levied against the debtors in bankruptcy and not against their lessors* (Petitioner's Brief, p. 16).

In reaching its result the District Court not only ignored the fact that Section 124a imposes upon the Trustees the same tax liability as the debtor itself would have if not in reorganization, but gave a highly strained interpretation to the word "business" as used in the Statute when it construed the word "business" to include not only the business of the debtor but also the businesses of the underliers. Section 124a makes the Trustees liable only for such State and local taxes as are applicable to the business being conducted by the Trustees. The Trustees admittedly have not been authorized to conduct and are not conducting the separate businesses of the underliers. They have been operating the business of the debtor, using in their operation the properties of the underliers to the same extent as and to no greater extent than the underliers' properties were used by the debtor prior to reorganization. The taxes assessed against the underliers are, therefore, not applicable to the business being operated by the Trustees.

The District Court's construction of the word "business" ignores the fact that the Trustees were appointed for the debtor to operate the debtor's business, and brings into consideration a fictitious personality — the entire transportation system—having no legal existence and without responsibility. The acceptance of this construction fails to take into consideration that, while the properties of the underliers are in the possession of the Court through its Trustees, the underliers themselves are not in reorganization and are not under the control

and direction of the Court. Moreover, the very taxes sought to be paid arise solely by reason of the existence of the separate corporate entities of the underliers and bear no relation to their properties being used by the Trustees or to the value of the properties to the Trustees.

It is submitted that the only business being conducted by the Trustees is that of the debtor, and the taxes of the underliers are applicable to that business only if the debtor's liability for such taxes is a tax obligation. As shown hereinbefore the debtor's obligation for the underliers' taxes is only a contractual obligation.

The most recent judicial pronouncement on this phase of the case at bar appears in the case of *Webster and Atlas National Bank of Boston v. Palmer et al.*, 111 F. (2d) 215, decided April 16, 1940, certiorari allowed October 14, 1940, No. 120 October Term, 1940.

The petitioners in the case at bar considered the *Webster and Atlas case* to be so identical with the instant case both as to the facts and as to the law applicable thereto, that it was referred to, relied upon and quoted at length in support of the petitions for certiorari to your Honorable Court. (Petition for Certiorari, page 7).

Even if the decision of the Second Circuit in that case should be sustained by your Honorable Court, it is respectfully submitted that such a conclusion would not of necessity rule the case at bar. The facts in the case of *Webster and Atlas National Bank of Boston v. Palmer et al., supra,* and in the instant case are patently dissimilar and the principles to be deduced from these cases are accordingly so unlike that the decisions in the two Circuits could both stand without destroying the pattern of judicial concepts.

The following fact situation was before the Court in the *Webster and Atlas National Bank of Boston v. Palmer* case:

The Trustees of the New York, New Haven and Hartford Railroad Company, debtor in reorganization under Section 77 of the Bankruptcy Act, were using in connection with their operation of the debtor's business, the properties of two lessors. When the lessors' lines were found to be unprofitable to the debtor, the Trustees were permitted to reject the leases. Since as a practical matter the lessors were unable to operate their own properties, the Court was forced, in the public interest, to direct the Trustees, pursuant to Section 77 (c) (6) of the Bankruptcy Act, *to continue the operation of the rejected lines for and on account of the lessors.*

Thereafter, the Trustees of the New Haven, asserting that the rejected leased lines were being operated unprofitably, and that the continued diversion of the New Haven funds to meet the expenses of operating the lessors' lines would prejudice the creditors of the New Haven Railroad Company, petitioned the District Court for authority to withhold payment of the lessors' taxes. The District Court thereupon directed the withholding of payment. The Circuit Court of Appeals for the Second Circuit reversed this order on the ground that the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a) required the Trustees of the New Haven to pay the lessors' taxes so long as they operated the lessors' lines.

There are real and controlling distinctions between the facts of that case and the fact situation obtaining in the case at bar:

1. In the case at bar the Trustees, while using in connection with the operation of the debtor's business

certain properties of the underlying lessors, have neither rejected nor affirmed the lease and operating agreements with the underlying lessors.

In the *Webster and Atlas National Bank of Boston v. Palmer* case the lease agreements were specifically rejected by the Trustees pursuant to Court order.

2. In the case at bar the properties of the lessors are being operated by the Trustees of the debtor lessee incidental to, in connection with and as part of the operation of the debtor's business, and *not as separate businesses for or on account of the lessors.*

In the *Webster and Atlas National Bank of Boston v. Palmer* case the operation by the Trustees of the lessee of the properties of the lessors was specifically separated from the operation of the debtor's properties and business and was by Court order *operated as separate businesses for and on account of the lessors.*

It is noteworthy, moreover, that the *Webster and Atlas* decision is based upon a construction of Section 77 (c) (6) relating to interstate railroads, which has no counterpart in Chapter X of the Chandler Act or in Section 77B, which it replaced. Section 77 (c) (6) specifically empowered the Court to order the Trustees, after the rejection of the leases, to operate the lines for and on behalf of the lessors. No such order was made in the instant case, nor have the leases been rejected.

It is thus patent that there are vital and controlling distinctions in the two cases that require the application of entirely different principles of law.

Seemingly, petitioners themselves realize the inapplication of the *Webster and Atlas National Bank of Boston v. Palmer* decision, for despite the great stress placed

upon the decision in the brief supporting the petition for certiorari, the brief now before your Court, filed by the Petitioners, contains only a passing and casual reference to the case and nowhere discusses either its facts or the legal principles deducible therefrom. (See Petitioners' Brief, p. 27.)

Section 124a does not impose greater tax obligations upon the Trustees than was imposed by law upon the debtor prior to reorganization. Since the debtor's obligation under its leases for the payment of taxes of its lessors was not a tax obligation under the authorities hereinbefore discussed, what basis is there for holding that Section 124a makes the Trustees liable as taxpayers for the taxes of the underliers? It is submitted that there is no tenable basis for this conclusion, for the properties of the underliers being utilized by the Trustees in connection with the operation of the debtor's business are identical in character and extent of use with those used by the debtor in its operation prior to reorganization.

It is earnestly submitted, therefore, that Section 124a by its express language renders the Trustees of the debtor in reorganization responsible only for the taxes of the business being operated by them—the taxes of the debtor—and does not render the Trustees liable for the taxes of the underliers, for which taxes, as such, the debtor is not liable.

Section 124a Does Not Violate the Fifth Amendment to the Constitution.

Petitioners further contend that unless their interpretation of Section 124a is adopted, the section is unconstitutional because it deprives the underliers of their property without due process of law in violation of the

Fifth Amendment of the Constitution of the United States (Petitioners' Brief, p. 14). It is submitted that a construction of Section 124a, which limits the tax obligation of the Trustees to the same tax obligation as the debtor itself would have if not in reorganization, does not deprive the underliers of their property without due process of law. If the taxes, penalties and interest become liens upon the properties of the underliers, it is not by virtue of the Congressional statute or the interpretation thereof by the courts; they become so by virtue of the acts of the underliers themselves who have permitted their earnings to become commingled with those of the debtor, and for reasons advantageous to petitioners, consented to a system of bookkeeping which makes it difficult to ascertain the net earnings of the underliers. Respondents are not opposed to the payment of the underliers' taxes if the underliers establish their respective net earnings during the period of administration by the Trustees. To require the underliers to prove their claims by establishing their net earnings, as does the decision of the Circuit Court of Appeals, does not result in depriving them of their property without due process of law. It is an elementary legal principle that he who asserts a claim must prove it. The denial of a claim because of lack of proof does not deny due process to the claimant.

Nor does the fact that certain of the debtor's taxes are to be paid while the underliers taxes are not being paid deprive petitioners of their property without due process of law. The debtor's taxes stand upon an entirely different footing. The debtor's taxes are clearly a tax obligation, and as such, are entitled to payment in priority over other administration expenses, such as use and occupancy payments. This is well brought out in the Report of the Special Master, who stated as follows (R. 65):

"20. There is authority for the doctrine that taxes are entitled to priority over other administration expenses: Atkinson & Co. v. Alrich-Clisbee Co. (D. C. Mass. Morton J.) 248 Fed. 134; Piedmont Corp. v. Gainesville & N. W. R. Co. (Dis. Ct. Ga. Sibley J.) 30 F. (2d) 525; Coy v. Title Guarantee & Trust Company (C. C. A. 9th) 220 F. 90; Union Trust Co. v. Illinois M. R. Co. 117 U. S. 434, 481, 29 L. Ed. 963, 979. Whether or not that be so generally, in the present case it appears equitable that they be given priority over the possible claims of trackage owners for the use of the properties.

21. It is the duty of a common carrier to furnish and operate 'a reasonably sufficient number of safe facilities, and run and operate the same with such motive power as may reasonably be required, in the transportation of all such passengers or property as may seek, or be offered to it, for such transportation * * *': Pennsylvania Act of May 28, 1937 P. L. 1053, Section 403, Purd. Pa. Digest, Title 66 Section 1173. This duty of the underlying companies which own the tracks and franchises has been performed by Pittsburgh Railways Company or its receivers or trustees since 1902. The underlying owner companies are not presently prepared to resume the performance of their duty to the public. Even if they had the necessary capital, cars and personnel, their several properties have for a generation been operated as a unit and by force of circumstances the operation of many of them has become dependent upon the operation of others of them. It can hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they

are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated. That operation appears to be as much for the benefit of the owner companies and their creditors as for the benefit of Pittsburgh Railways Company and its creditors. To the extent that the operation proves profitable, the underliers can be paid something for the use of their properties, probably more than they would have earned separately. Should the profits prove inadequate and the administration be insolvent, there will be nothing for the stockholders and creditors of Pittsburgh Railways Company, except in so far as those creditors have a lien on a minor part of the mileage, but the operation of the system will have preserved or tended to preserve the properties of the owner companies. The operation and management of the properties being for the common benefit, the current expenses thereof should be paid currently even though there ultimately may not be enough to pay the potential separate claims of the owner companies for compensation for the use of their properties."

Petitioners' argument in this respect overlooks the salient fact that the operation of the underliers' properties by the Trustees is just as much for the benefit of the underliers as it is for the benefit of the debtor. *In the Matter of Connecticut Company,* 95 F. (2d) 311. In order to preserve the underliers' franchises, their respective properties must be operated. None of the underliers has any equipment or other facilities with which to operate its lines. They have not demanded the return of their properties. They well know that they would be in a position where they would have no properties whatsoever because their franchises have lapsed because of discontinuance of service.

The construction contended for by petitioners would, however, deprive *respondents* of *their* property without due process of law. To permit the payment of the underliers' taxes as a tax obligation would impose upon respondents, unsecured creditors of the debtor, the burden of paying the taxes of the underliers to the extent that the net earnings of each underlier was insufficient to meet its taxes—a burden which should be borne by the underliers. Funds which should go to the creditors for their claims will be invaded to pay the taxes of the underliers.

III. Where the Underlier Companies Have Maintained Their Separate Corporate Structures for Thirty-eight Years, Their Identities Will Not Be Erased for the Benefit of the Holding Company and the Underliers, to the Detriment of Creditors.

The Trustees of the Pittsburgh Railways Company, the debtor in reorganization, recommended the payment of all taxes as an administration expense, even though none of them was, assessed against the debtor and despite the fact that the underliers were not in reorganization (R. 93). The Philadelphia Company, holding company of the debtor, and certain of the underliers claimed that aside from any obligation to pay these taxes that arose under the lease and operating agreements, as a matter of general law all taxes, Federal as well as State, should be paid as an administration expense, because of the fact that the debtor and underlying companies have been operated as a single unified transportation system. They adopted the Trustees' contention that:

> "Whatever may be the technical legal relationship existing between Pittsburgh Railways Company and its underlying street railway and incline plane companies, in point of fact and for all prac-

tical purposes all those companies have been operated as a single and unified transportation system since 1902, and they are now being operated as such by the Trustees of Pittsburgh Railways Company, debtor. The operation of the business of the several companies as a unified system was brought about by the voluntary action of those companies." (R. 93)

It is quite true that since 1902 the street railway system in Pittsburgh has been owned by more than fifty companies, operating under a cumbersome holding company structure as a unified transportation system. It would appear that the retention of the "technical legal relationship" had certain measurable advantages, since not even the receivership of 1918-24 resulted in the elimination of all the underlier companies. It is noteworthy that the underliers have not voluntarily submitted themselves to the jurisdiction of the Court in the present reorganization and are not presently under the supervision, control or direction of the Court.

The Philadelphia Company, holder of all the stock of the Pittsburgh Railways Company, has not always been so ready to ignore the technicality of the relationship between itself and the debtor and the fifty-five underliers. For the purpose of escaping liability on underliers' bonds and avoiding payment of municipal liens, they have clung tenaciously to the legal concept of separate corporations. Judge Maris, in delivering the Opinion of the Circuit Court in the case at bar, states at page 933 (R. 106):

"The appellees argue that since the properties of the underlying companies are in the possession of the trustees of the debtor and are being used and operated by them with properties of the debtor as a unified system the taxes of the underlying companies are, in effect, taxes of the unified system and

are, therefore, operating and administrative expenses of the trustees.[3] The district court adopted this view.

We are asked to ignore the legal relationships existing between the Philadelphia Company,[4] the debtor and the underliers[5] and their separate corporate identities and treat them all as one unified transportation system. For all practical purposes, the appellees argue, the separate identity of the underlying corporations has been lost. We are not impressed with the equity of this plea. Under other circumstances the appellee, the Philadelphia Company, has not sought to ignore its corporate identity but has taken refuge behind it to escape liability upon an underlier's bond,[6] as has also the debtor[7]

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[3]The trustees state:

'We do not contend these taxes are payable because the debtor contracted to pay them. While such contracts exist, thus far the Trustees have not affirmed them and may never do so. Whatever might be the effect of affirmance of the operating agreements and leases on the obligation of the Trustees to the underliers, we submit that the obligation of the Trustees to the taxing authorities is not governed by those contracts or by any action that might be taken by the Trustees with respect to them. Nor do we contend these taxes are payable as compensation for use and occupancy of the underliers' properties by the Trustees.'

[4] The Philadelphia Company is the holding company which owns all the stock of the debtor.

[5] The debtor has an investment of approximately $32,000,000 in the stock of the underliers.

[6] *Allen v. Philadelphia Co.*, 265 F. 807, affirmed 265 F. 817. *Cf. Ambridge Borough v. Philadelphia Co.*, 283 Pa. 5, 129 A. 67.

[7] *Sec. Ave. T. Co. v. U. T. Co. of PBG.*, 328 Pa. 257, 195 A. 25.

and an underlier.[8] The appellees, the Philadelphia Company and the underliers, appear not too sincere in their contention that the corporate form is merely fiction when it is observed that the underliers have refrained from themselves filing petitions for reorganization, with the result that the only corporations in the system which are in process of reorganization are the debtor and its subsidiary. The Trustees are not trustees for the Philadelphia Company nor for any of the underliers. Neither the past history of the system nor the present state of the reorganization proceedings would, we think, justify our ignoring the existence of the separate legal entities which compose that system."

It is earnestly submitted that corporate capacity is a legal fact, not a fiction. The corporate separation in the case at bar, though purely formal, was none the less a reality for thirty-eight years.

Where adherence to the distinct or separate existence of corporations would sanction a fraud or result in the evasion of the law or other injustice, courts have not hesitated to disregard the entity concept. But those well recognized variations in the pattern of judicial thinking afford no basis for the plea of a holding company that its carefully cumbersome underlying system should be merged, momentarily, for the sole purpose of paying the underliers' taxes from the assets of the debtor, to the impairment of rights of creditors.

While the dominant consideration in the reorganization proceeding is, as argued by petitioners, the development and consummation of a plan of reorganization, it is respectfully submitted that to disregard the corporate entities of the underliers will in no way facilitate the

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[8] *Lyon v. Pitts. A. & M. Tr. Co.*, 312 Pa. 584, 169 A. 229."

development of a plan of reorganization. The plan of reorganization contemplated by the Trustees envisages a single new company which will acquire title not only to the properties of the debtor but also to those of the underliers (R. 93). This means the rejection of the leases. One of the key problems in the proceedings will be the question of the allocation of the securities of the new company among the security holders of the underliers. This will require ascertainment of the value of the several properties of the respective underliers and the evaluation of the respective components of the system. In distributing the securities the Trustees will first have to clear up some of the chaos which permeates the entire proceeding. The amount of the taxes now owed by the underliers will necessarily reduce the purchase price to the new company. To ignore the corporate entities of the underliers at this time will only add more chaos to the existing unsatisfactory state of affairs and increase the burden of developing and consummating a plan of reorganization. Sooner or later this onerous problem must be solved; this is an appropriate time to begin untangling the threads.

IV. While the Trustees Are Liable to the Underliers for Use and Occupancy of Their Properties, the Taxes Assessed Against the Underliers Cannot Be Paid as Advances on Use and Occupancy Allowances.

Inasmuch as the debtor's liability for the taxes of its underliers is a contractual obligation under its executory contracts with the underliers, the liability of the Trustees to the underliers for taxes and other payments is governed by the equitable and legal principles established with respect to the liability of Receivers and Trustees under the executory contracts of their debtor. These principles are well summarized in the opinion of

the Circuit Court of Appeals in the statement of Judge Maris at 111 F(2d) 932 (R. 108):

> "The trustees have no obligation to pay the rentals due under the leases, as such, unless and until they affirm the leases and operating contracts. They have a reasonable time within which to affirm or disaffirm. During the interim their sole obligation is to pay the lessors a reasonable amount for the use and occupation of the properties actually in use. This rule, which was originally laid down in railroad receiverships in equity applies to the reorganization of a street railway under Section 77B of the Bankruptcy Act. If an interim payment is made it is ordinarily held that it should not be in an amount in excess of the net earnings derived from the operation of the lessor's properties."

These principles have been established in a long line of cases in this Court and other Federal Courts. *United States Trust Company v. Wabash Railway,* 150 U. S. 287; *Pennsylvania Steel Co. v. New York City Ry. Co.,* 198 Fed. 721 (C. C. A. 2d Cir. 1912); *American Brake Shoe & Foundry Co. v. New York Rys. Co.,* 282 Fed. 523 (C. C. A. 2d Cir. 1922); *Westinghouse Electric & Mfg. Co. v. Brooklyn Rapid Transit Co.,* 6 F(2d) 547 (C. C. A. 2d Cir. 1925); *In re Connecticut Co.,* 95 F(2d) 311 (C. C. A. 2d Cir. 1938), cert. denied sub nom. *Connecticut Railway & Lighting v. Connecticut Co.,* 304 U. S. 571; *Tardy's Smith, Law and Procedure of Receivers,* (Second ed., 1920, Volume I, page 278; *Clark, Foley and Shaw, Adoption and Rejection of Contracts and Leases,* 46 Harv. Law Rev. 111.

Inasmuch as the Trustees' liability to the underliers is limited by the net earnings of each underlier, it follows as a necessary corollary that the net earnings of each of the underliers must be shown before any payments can be made to it. The reason for the rule has been well stated by the Circuit Court of Appeals in

Public Service Commission v. Philadelphia Rapid Transit Company, 82 F(2d) 481 (C. C. A. 3rd Circ., 1935), Judge Davis, speaking for the Court, stated at page 487:

> "As to the allowances for the use and occupation of the properties leased by the Philadelphia Rapid Transit Company from the underliers, we held, and reaffirm our position, that creditors in a bankruptcy proceeding are entitled to know what property was used and occupied and the extent of that use and occupancy before allowances may be made therefor, and this is particularly so in view of the contention that the debtor is paying for property which it does not occupy or use.
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> *The underliers, like any other person in any bankruptcy proceeding, are entitled to be justly and fairly paid for the use and occupancy of their property;* but, like any other person, they should and must show what that property is and that it is occupied *and used.* They occupy the same position as any other person whose property is being used by receivers and trustees in bankruptcy, and like any other person *they cannot expect a court of bankruptcy to make allowances until they show just what property is being used and occupied and the extent thereof.* Until a court knows that, how can any fair and just allowance be made? When these are shown, surely proper allowances will and should be made, but until then, can they in good faith ask or demand allowances, when no step has been taken to supply the court with this information? If any one in the meantime suffers or is inconvenienced the court is sorry, but the fault cannot be charged to it." (Italics ours).

The decision in *Philadelphia & Reading Coal & Iron Company v. Van Deusen,* 103 F(2d) 869 (C. C. A. 3rd Circ.), is to the same effect.

No evidence has been adduced in the case at bar as to the net earnings of the fifty-five underlier lessors whose properties are being utilized by the Trustees of the debtor in reorganization. It has been strenuously urged that due to the fact that since 1902 all the funds realized from the operation of the transportation system, including those derived from the use of the underliers' properties, have been commingled, that there is no data from which the separate earnings of the underliers can be readily compiled. It is, therefore, claimed that the use and occupancy rule should not be invoked in the instant case.

It is indeed an anomalous position for a holding company which has created and carefully maintained a cumbersome intercorporate structure for thirty-eight years, and for the underliers who acquiesced in this arrangement, to now ask to be absolved from proving their claim because of certain difficulties engendered by the system they chose to adopt.

It is significant that the very taxes which it is contended the Trustees should pay because of the integration of the system are only payable because of the existence of the separate corporate structures of the underliers.

No one questions the reality of the difficulties with which lessors are confronted in attempting to prove net earnings of the fifty-five underlying companies for the purpose of establishing proper charges for use and occupancy. The properties of the underlying companies have not been separately operated since 1902. The funds have all been commingled and no separate book-

keeping system kept. However, the situation was created by petitioners and the respondents should not be asked to shoulder the burdens resulting therefrom.

In other cases of commingling the Courts have not removed the burden from the backs of the owners who willfully commingled the funds, but placed upon such commingers the duty of disentangling the chaos thereby created.*

In the case of *Federal Trade Commission v. Thatcher Manufacturing Co.*, 5 F. (2d) 615 (Circuit Ct. of Appeals, 3d Circuit), Judge Wooley, speaking for the Court, stated (p. 621):

> "In effecting the remedy, however, the Commission must meet the situation as the offending corporation has made it * * * Nor do the acts of the offending corporation in commingling the assets of the corporation whose stock it has acquired in violation of the Statute with assets of its own, raise a legal barrier against remedying an evil which the law was expressly enacted to prevent. Just how, in a practical way, this shall be done in the case at bar, the Commission purposely left open by the last paragraph of the order *which directed the respondents to submit a plan to that end.*" (Italics ours).

We are confident that the underliers in the case at bar can and will eventually evolve some appropriate and equitable method of determining the amount of the use and occupancy charges to be paid by the Trustees.

Petitioners urge that because of their inability to show the net earnings of the underliers, the principle

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* *Broom's Legal Maxims* (6th American Edition), p. 212, star p. 275. *Little v. Fleischman*, 98 S. E. 455, p. 458. (N. C. 1919.)

of net earnings is inapplicable in the instant case under the doctrine enunciated in *North Kansas City Bridge & Railroad Co. v. Leness,* 82 F. (2). 9 (C. C. A. 8th, 1936). That case is clearly inapplicable to the present situation. There the leased property was not a railway line but a connecting bridge which was non-revenue producing. Being non-revenue producing property, the Court likened it to other non-revenue producing property such as a depot or terminal which is necessary to the operation of business but which is wholly without revenue-producing capacity. The Court accordingly held that the net earnings rule would not be applicable because the property involved did not produce any revenue. The Court, however, did not hold that it would not be necessary to establish net earnings in the case of revenue-producing properties where the net earnings were difficult of determination only because of the voluntary action of the lessors and lessee of commingling their funds and in failing to keep proper books and records.

The doctrine of the *Leness* case does not support petitioners' contention but strengthens the decision of the Circuit Court of Appeals in the instant case. It requires three things to be done before any payment can be made to or on behalf of the underliers: (1) a classification between revenue and non-revenue producing properties; (2) a determination of the use and occupancy of the non-revenue producing properties; and (3) a determination of the net earnings, if any, of the revenue producing properties. Until these three facts are determined, it is inequitable to pay anything to or on behalf of the underliers in the case at bar.

Finally, petitioners urge that the taxes of the underliers should be paid as they fall due and that the creditors will be protected by an order similar to that entered

in the New York, New Haven and Hartford reorganization, and tacitly approved by this Court in *Warren v. Palmer,* 310 U. S. 132, giving the Trustees a prior lien on the property of an underlier to the extent of the excess of the taxes paid on such property over its net earnings. (Petitioners' Brief, pages 26, 27).

It is respectfully submitted that such an order would not be proper in the present case at this time. The suggestion is here made for the first time. The District Court was not asked to consider such an order and its order directed the payment of the underliers' taxes without providing for any protection for the creditors. Such an order cannot be entered on the present state of the record. No notice has been given to the parties in interest of an intention to ask for a lien. While the underliers themselves may consent to such an order, their bondholders and stockholders have not been heard on the question. The present proceeding arose on a petition for instructions with respect to the taxes and not on a petition for leave to make a loan upon security.

Moreover, there is nothing in the record to show that the security offered is sufficient. There is nothing in the record to show that any particular underlier has property of its own sufficient to meet its taxes. It is no doubt true that liens on the properties of some of the underliers would be adequate protection. The difficulty here is that the record is silent as to which companies have valuable properties. Some of the underliers, for example the Consolidated Traction Company, are in themselves nothing more than intermediate holding companies with little or no property of their own. Yet the tax on such company is one of the largest. A lien on their properties might be valueless. Before the creditors can be said to be protected by a first lien on the properties of underliers, it must be shown that prop-

erty of each underliers is worth the amount of the lien on that property. The fear that a particular lien would be valueless is not groundless if we consider the situation that has arisen in *Webster & Atlas National Bank v. Palmer*, now pending in this Court at No. 120 October Term, 1940, where the amount of the lien is now alleged to be greater than the value of the property.

To allow an advance in the absence of the requisite proof would clearly be unfair to creditors of the debtor. The Master has found that the payment of the underliers' taxes by the Trustees without requiring them to first establish their net earnings might result in preferences or overpayments (R. 67). While a possible preference might not injure the creditors of the debtor since the claims of the underliers when determined will be expenses of administration, any overpayment would seriously injure the creditors. If overpayments are made by the debtor, the overpayments will be made out of the funds and assets of the debtor and will reduce the assets available for the payment of the claims of unsecured creditors. The creditors will have their claims diminished to the extent of such overpayment.

Moreover, the Master to whom this matter was referred by the District Court found as a fact that the debtor Railways Company has substantial charges against some of the underlying companies, the amounts of which have not as yet been determined and are in dispute (R. 64). These charges will doubtlessly affect the amounts ultimately due the underliers on their use and occupancy claims and might in certain instances entirely erase the claims.

It would clearly be inequitable under these facts to allow the taxes of the underliers to be paid as an advance on use and occupancy payments which might never be proved.

CONCLUSION.

In conclusion, it is earnestly submitted that the fundamental error in the position of the petitioners arises out of their failure to differentiate between contractual obligations and tax obligations. The Pittsburgh Railways Company, by virtue of the covenants in the leases with the underliers, assumed an obligation to pay the taxes of the underliers. The filing of the petition for reorganization did not change the character of the obligation of the debtor.

Neither Section 124a of the Judicial Code nor the fact that the Trustees were utilizing the properties of the underliers in connection with their operation of the debtor's business, convert this unsecured contract claim into an administrative tax claim. Nor can any process of legal legerdemain enlarge the duties of the Trustees with respect to the tax obligations of a debtor lessee in reorganization to include the payment of taxes assessed and levied against its lessor underlying companies.

The only justification for paying these taxes is to construe them as advance payments for use and occupancy. Having failed to establish their net earnings, the measure of use and occupancy in cases of this genre, the underliers have established no tenable basis for any payments by the Trustees. Any payment at this time on this record would inevitably result in the undue favoring of the underliers at the expense of the unsecured creditors.

As it was pertinently stated by the learned Circuit Court of Appeals in the case at bar, at page 108:

> "It may be, as argued by the appellees, that in this case it is impossible fairly to allocate the net earnings of the system to the various leased lines.

In that case it may be necessary for the court to fix an allowance for use and occupation upon the basis of the fair value of the property actually used by the trustees. This we need not now determine for the court must first determine the property which is being used, the extent of its use and the net earnings being derived from it or its value. Until that is done any order made by the court would have no factual basis and would, therefore, be arbitrary and possibly confiscatory."

It is earnestly submitted that the decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

WM. ALVAH STEWART,
Solicitor, City of Pittsburgh;

ANNE X. ALPERN,
First Assistant City Solicitor of Pittsburgh;

LEON WALD,
Special Counsel for City of Pittsburgh,
Counsel for City of Pittsburgh, Respondent.

A. E. KOUNTZ,
LEWIS M. ALPERN,
SOLIS HORWITZ,
Counsel for Tort Creditors' Committee, Respondent.

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FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

NOS. 242 AND 243.

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

MOTION FOR LEAVE TO INTERVENE

by

W. D. GEORGE, THOMAS M. BENNER and THOMAS FITZGERALD, Trustees of Pittsburgh Railways Company, Debtor, and of Pittsburgh Motor Coach Company, Subsidiary.

H. V. BLAXTER,
J. HENRY O'NEILL,
J. GARFIELD HOUSTON,
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MOTION FOR LEAVE TO INTERVENE

by

W. D. GEORGE, THOMAS M. BENNER and THOMAS FITZGERALD, Trustees of Pittsburgh Railways Company, Debtor, and of Pittsburgh Motor Coach Company, Subsidiary.

To the Honorable Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary, by the undersigned, their attorneys, move your

Honorable Court for leave to intervene in the above-entitled cases and respectfully represent:

1. On May 10, 1938 Pittsburgh Railways Company, debtor, and Pittsburgh Motor Coach Company, subsidiary, Pennsylvania corporations, filed their respective petitions for reorganization under the provisions of Section 77B of the Bankruptcy Act in the District Court of the United States for the Western District of Pennsylvania, and on the same day the Court entered Orders approving the said petitions as properly filed and continuing the debtor and the subsidiary in possession.

2. On June 14, 1938 W. D. George, Thomas M. Benner and Thomas Fitzgerald were, by Orders of the said District Court, appointed Trustees for the debtor and for the subsidiary and they duly qualified and, since the date of their appointment, have acted and are now acting as such Trustees.

3. The Order of Court entered June 14, 1938 appointing Trustees for the debtor authorized the Trustees, *inter alia,* to preserve, maintain, manage and operate the property and estate in possession of and/or owned by the debtor, and to manage and conduct its business.

The Order of Court entered the same date appointing Trustees for the subsidiary conferred similar authority upon the Trustees with respect to the estate of the subsidiary and the conduct of its business.

4. Pursuant to the said Order of Court appointing Trustees for the debtor, the Trustees took possession of and occupied and used, and are now in possession of and occupying and using, in the operation of the debtor's business the property of the debtor and the properties of fifty-five street railway and incline plane companies, hereinafter referred to as "underliers", whose properties were, at the time of the filing of the debtor's petition on

May 10, 1938, in possession of the debtor under certain leases and operating agreements; and, similarly, pursuant to the Order of Court appointing Trustees for the subsidiary, the Trustees took possession of and are now occupying and using the property of the subsidiary in the operation of its business.

5. On March 10, 1939 the Trustees of the debtor and of the subsidiary presented their petition to the District Court praying that the Court instruct them as to what action they should take with respect to the payment of certain taxes of the debtor and of the subsidiary and of the underliers of the debtor. The District Court, by Order entered October 26, 1939, instructed and directed the Trustees of the debtor to pay the taxes of the underliers, with certain qualifications not here material, together with any penalties and interest which may have accrued thereon. The directions of the Court with respect to the taxes of the debtor and of the subsidiary are not here involved.

6. A committee known as the Tort Creditors' Committee and the City of Pittsburgh separately appealed to the Circuit Court of Appeals for the Third Circuit from the said Order of the District Court of October 26, 1939 in so far as that Order directed the Trustees to pay the underliers' taxes. The Philadelphia Company, a creditor of the debtor, certain underliers, and the Trustees of the debtor and of the subsidiary were appellees in the Circuit Court.

The Circuit Court of Appeals reversed the Order of the District Court in so far as it directed the payment of the taxes involved in the appeals, to-wit, the taxes of the underliers.

7. The petition of the Philadelphia Company and certain underliers for writs of certiorari to review the judgments of the Circuit Court of Appeals was granted

by your Honorable Court and the cases are now pending herein at the above numbers and term. Walter L. Dipple *et al.*, a committee known as the Tort Creditors' Committee, and the City of Pittsburgh are the respondents in said cases.

8. The controversy now before your Honorable Court was initiated through a petition for instructions which the Trustees filed in the District Court and involves the question whether the Trustees of the debtor should pay certain taxes of the underliers as administration expenses of the trusteeship. The Trustees, therefore, believe that it is appropriate for them to become parties of record in the aforesaid cases now pending before your Honorable Court and to submit themselves to such Orders as may be entered therein.

WHEREFORE, W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary, through their undersigned attorneys, respectfully move your Honorable Court to grant them leave to intervene in the aforesaid cases and become parties of record therein.

H. V. BLAXTER,

J. HENRY O'NEILL,

J. GARFIELD HOUSTON,

Attorneys for W. D. George, Thomas M. Benner and Thomas Fitzgerald, Trustees of Pittsburgh Railways Company, debtor, and of Pittsburgh Motor Coach Company, subsidiary.

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P6

SUPREME COURT OF THE UNITED STATES.

Nos. 242, 243.—October Term, 1940.

Philadelphia Company, et al., Petitioners,
vs.
Walter L. Dipple, James P. McArdle, Ben Paul Brasley, and Thomas J. Hoffman, etc., et al.

On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[February 3, 1941.]

Mr. Justice Roberts delivered the opinion of the Court.

This case presents a problem similar to that involved in No. 120. Here the debtor instituted a reorganization proceeding under § 77B of the Bankruptcy Act (now chapter X of that Act)[1] and the question presented is whether the trustees should be directed to pay taxes owed by corporations whose properties the debtor operated under leases and operating agreements and the trustees continued to operate. Although the courts below did not refer to the Act of June 18, 1934,[2] the petitioners' insistance that the decision of the Circuit Court of Appeals is in the teeth of the provisions of the Act and conflicts with the decision of the Circuit Court of Appeals of the Second Circuit in *Palmer* v. *Webster and Atlas National Bank*, No. 120, caused us to grant certiorari.

The debtor, Pittsburgh Railways Company, has, for many years, possessed and used the properties of some fifty-five street railway companies and has operated those properties, in connection with its own, as a unified street railway system in Pittsburgh, Pennsylvania, and surrounding territory. The debtor obtained possession of the properties of the underlying companies through leases and operating

[1] § 77B was adopted June 7, 1934, 48 Stat. 912, and was amended Aug. 29, 1935, 49 Stat. 965, and Aug. 12, 1937, 50 Stat. 622. By the terms of the Chandler Act adopted June 22, 1938, 52 Stat. 840, 883, the provisions of § 77B were superseded by chapter X of the Bankruptcy Act and that chapter was made applicable, so far as practicable, in cases pending when the Act took effect. The petition in this case was filed May 10, 1938, and the Chandler Act became effective Sept. 22 of that year.

[2] 48 Stat. 993, 28 U. S. C. § 124(a).

agreements which required the debtor to pay all expenses of operation and maintenance and all the taxes of the underlying companies. The system comprises some 560 miles of track, incline plane railways, cars, car barns, and buildings. The debtor owns 28 miles of the track and owns cars and other property. Pursuant to the terms of the leases and agreements, the debtor has directly paid the expenses of operating, maintenance charges, and all taxes of the underlying companies. After the filing of the debtor's petition under § 77B, its approval, and an order continuing the debtor in possession, the court, June 14, 1938, appointed trustees with authority to maintain, manage, and operate the property in possession of, or owned by, the debtor; to manage and conduct its business; collect the revenues therefrom, and to pay all taxes and assessments due, or to become due, upon property in possession of, or owned by, the debtor. The trustees have since been operating the business, using therein the properties of the underlying companies. They have not affirmed or disaffirmed the leases and operating agreements.

March 10, 1939, the trustees petitioned the District Court for instructions respecting the payment, as administration expenses, of taxes assessed against the debtor, a subsidiary, and the underlying companies.[3] The petition was referred to a master before whom objections were filed by the City of Pittsburgh, a creditor, and also by a creditors' committee, to the payment of the taxes assessed against the underlying companies. These consisted of Pennsylvania corporate stock taxes, Pennsylvania corporate net income taxes, Pennsylvania corporate loan taxes, and Federal income taxes, some of which accrued and became payable subsequent to the filing of the petition for reorganization and some of which accrued prior thereto. The present petitioners appeared before the master and advocated an order for payment of the taxes.

It appeared from the trustees' petition that they had on hand an amount sufficient to pay all the taxes as to which they requested instruction and that none of the underlying companies had funds with which to pay any of the taxes assessed against them. The testimony before the master showed that during the existence of the unified system no attempt was made to account for the revenues and operat-

[3] The terms of the order ultimately entered with respect to taxes of the debtor and its subsidiary are not here drawn in question.

ing expenses of individual underlying companies; that any attempt to account for the revenues and expenses of individual companies would be very expensive and the results would not be sufficiently accurate to form a basis for allocating the items; that it was impossible to operate each underlying company separately so as to ascertain the net earnings of each, and that it was probably impossible to determine what would be the fair proportion of rentals to be paid to the various underlying companies whose properties were utilized by the debtor and are now utilized by the trustees. There was testimony that it was impracticable at the time of the hearing for the trustees to state what properties of underlying companies would be embraced in the contemplated plan of reorganization.

In his report, the master recommended that the trustees be directed not to pay taxes assessed against the underlying companies at the present time. This recommendation was supported by a finding that it was uncertain that any of the leases would be affirmed by the trustees and that, in the absence of evidence that the net earnings of each underlying company equalled its taxes, payment of taxes might result in preferment or overpayment. Furthermore, the master found that claims of the debtor against certain of the underlying companies might extinguish any existing equities in the properties of the latter.

After a hearing on exceptions to the master's report, and after receiving a recommendation from the trustees as to what taxes of the underlying companies should be paid, the District Court entered an order that the bulk of the taxes of the underlying companies should be paid by the trustees. The decree was predicated upon the fact that the system had been operated as a unit for many years; that all income derived from the lines of the underlying companies had been kept in one fund, and that it was equitable that the taxes of the underlying companies be treated as taxes of the debtor.

Upon an appeal by the creditors' committee and by the City of Pittsburgh, the Circuit Court of Appeals reversed the order of the District Court so far as it applied to the taxes of the underlying companies.[4] That court held that the debtor's undertaking to pay the taxes of the underlying companies was merely a portion of the consideration for the use of their prop-

[4] 111 F. (2d) 932.

erty and was, therefore, a rental obligation and not a tax liability. The argument was pressed upon the court that the separate corporate entities of the underlying companies should be disregarded. In view of the fact that none of the underlying companies had filed petitions for reorganization, and thus subjected themselves to the jurisdiction of the court, the Circuit Court of Appeals held that, until affirmation of the leases and operating agreements by the trustees, their sole obligation was to pay a reasonable amount for use and occupation which could not be in excess of the net earnings derived from the operation of each property and could not be ascertained until it was determined what property was being used, the extent of the use, and the net earnings derived from it or its value.

The petitioners challenge the decision on the ground that it is contrary to the terms of the Act of June 18, 1934,[5] which directs that a trustee appointed by a court of the United States who is authorized to conduct any business, or does so, shall be subject to all state and local taxes applicable to the business; and on the further ground that it is violative of accepted principles of equitable administration of estates in receivership or reorganization.

The situation here differs from that disclosed in No. 120, in that § 77B contains no provision requiring the debtor to continue to operate the business of a lessor upon rejection of the lease. It further differs in that, here, the trustees have neither affirmed nor disaffirmed the leases and operating agreements. Another difference is that, in the present instance, none of the lessors or underlying companies is in reorganization.

Notwithstanding the fact that § 77B gives no specific authority to trustees in reorganization to reject burdensome leases or contracts, it is well settled that they have that right and are accorded a reasonable time within which to exercise it. If, in the opinion of the officers of the underlying companies, a reasonable time has expired those companies are not without redress. They may declare a forfeiture of the leases and abrogate the agreements for nonperformance on the part of the trustees or, they may apply to the District Court to compel an election by the trustees, to affirm or disaffirm. In the meantime, if the situation were such as to permit a proper calculation of the amount due for use and occupation, it

[5] *Supra*, Note 2.

would be proper for the court to order the trustees to pay a reasonable sum to be treated as a payment for use and occupation in the event that the leases and agreements are disaffirmed or, on account of rent, in the event they are affirmed. But this record furnishes no basis for such a calculation. The master has found, and the finding is not challenged, that there is no data available from which it can be determined what is the value of the various underlying properties or what is the fair value of their use. It is evident that the debtor has welded these underlying properties into one system in such fashion that a single route or a single passenger ride may involve the use of a number of the underlying companies' properties. Ascertainment of a proper apportionment of the receipts of the system as a whole to the respective contributions of the underlying companies' properties is obviously almost an impossible task. Moreover, since the underlying companies are simple contract creditors, an overpayment to any one of them might work a preference as against other such creditors, including the City of Pittsburgh and the tort claimants who are respondents here.

In the light of these facts, it becomes evident that the Act of 1934 has no application. The trustees are operating the business of the Pittsburgh Railways Company, a corporation of Pennsylvania. The District Court has ordered them to pay the taxes due by that corporation and by its wholly owned subsidiary, a bus company. In that aspect the order is not attacked. But the trustees are not operating the business of the various underlying companies. It may well be that the only business those companies have is to collect or enforce payment of the rentals and considerations due them under the respective leases and operating agreements. But, even so, that business is not the business of the Pittsburgh Railways Company and the trustees are not trustees of any such business.

What has been said in No. 120 need not be amplified in this case. It is plain that the Act of 1934 is inapplicable.

The petitioners recognize that the authorities cited by them in which courts having charge of receiverships or of reorganization proceedings under § 77B have ordered the payment of taxes by a receiver or by trustees dealt only with the taxes of the corporation represented by the receiver, or for whose business the trustees were appointed. They contend, however, that the same principle ought

to apply here because the system operated by the Pittsburgh Railways Company is a unified system. They urge that the business is a single business. They show that for thirty-six years prior to the filing of the petition the identity of the lines of the underlying companies has been obliterated by the creation of a unified system of railway transportation and they say that ~~the corporate identity of the companies whose lines have gone into this system should be ignored and~~ the whole business treated as that of the Pittsburgh Railways Company now conducted by its trustees in reorganization. But, as we have said, the underlying companies' relation to the Pittsburgh Railways Company is that of creditor and debtor and no principle of equity justifies ignoring that relation when, so to do, might adversely affect the claims of other creditors.

For these reasons we hold the judgment of the Circuit Court of Appeals was right and should be affirmed.

So ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.